

Bowler, Tracey

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HMRC's discretion: The application of the ultra vires rule and the legitimate expectation doctrine

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HMRC's Discretion: The Application of the Ultra Vires Rule and the Legitimate Expectation Doctrine

TLRC
Discussion
Paper No. 10

Tracey Bowler
**Tax Law Review
Committee**

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The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE
(Tel: +44 (0)20 7291 4800)
(Fax: +44 (0)20 7323 4780)
(email: mailbox@ifs.org.uk)
(website: <http://www.ifs.org.uk>)

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1 Introduction

- 1.1 This is a discussion paper, written for the Tax Law Review Committee of the Institute for Fiscal Studies, considering the way in which the courts limit the exercise of discretion by HMRC, in particular by reference to the doctrine of legitimate expectation, and how this affects the interaction between taxpayers and the taxing authority. It is set against a background of increasing levels of discretionary power being given to HMRC and, as a result, increasing concern about the relationship between HMRC and taxpayers. The paper aims to promote discussion about the extent of HMRC's discretion in interpreting and applying the tax rules set out by Parliament and whether taxpayers' abilities to challenge the use of that discretion are sufficient. The paper identifies problems with the application of HMRC's discretionary powers and the ability of taxpayers to rely on the various forms of statements and guidance which HMRC are increasingly under pressure to provide, as well as considering the procedures for claiming reliance on statements. It also suggests some ways to improve the position and invites comments and debate of the issues.

2 Executive Summary

- 2.1 It is well recognised that HMRC needs to exercise some discretion in collecting and managing taxes in the UK. However, the scope and exercise of that discretionary power has limits which are shared by other public bodies and which have been set out by the courts in considering cases seeking judicial review of decisions made by public bodies.
- 2.2 One area in which the exercise of discretion is particularly encountered by taxpayers is that of the various forms of HMRC statement and practice. The range of statements has expanded significantly over recent years and includes not only specific clearances obtained by taxpayers after formal application, but also assurances given to particular taxpayers or taxpayer representative bodies, Extra Statutory Concessions, Statements of Practice, HMRC's Manuals, guidance notes, tax guides, briefing notes and bulletins. As the use of such material increases, so it becomes increasingly important to know to what extent taxpayers can rely on the statements.
- 2.3 The first question to be considered, regardless of the form of statement or practice, is whether carrying out the statement will be within HMRC's powers. If not, it will be 'ultra vires' and the courts will not perpetuate that unlawful action.¹ As a practical matter, this means that guidance which extends concessions not set out in legislation or which otherwise diverges from the legislation may be ultra vires and therefore incapable of being relied upon by taxpayers. The more that HMRC are required to set out tax rules in guidance

¹ However, recent cases have shown that the courts may give the taxpayer a short period of time to get their affairs in order, during which time the ultra vires statements can be relied upon.

rather than Parliament setting out those rules in legislation, the more risk there is that the guidance will be ultra vires. There are examples currently of guidance that most commentators would say is ultra vires.²

- 2.4 If it is accepted that legislation, as interpreted by the courts, is the primary source of tax law, the first way to limit the problems caused by the ultra vires rule is to limit the occasions on which guidance may fall foul of the rule. A first step would be to aim to provide legislation that is neither so wide that HMRC has to narrow its scope nor so inadequate that HMRC has to fill in the gaps.
- 2.5 That is not to say that very detailed and prescriptive legislation is necessarily the answer. It may mean that the legislative drafting varies according to the concepts involved, whether the provision is a charging provision or a relief, and which taxpayers are affected. For example, more complex and prescriptive legislation may be more appropriate for complex corporate issues. The TLRC would be interested to hear views on this in order to develop ideas in this area further.
- 2.6 However, accepting that there will still be occasions when HMRC statements may be found to be ultra vires, taxpayers who are aware of the issue are left in the unacceptable position of having to choose between relying upon HMRC's guidance, which could be withdrawn or changed at any time, and applying their own analysis of the legislation, which may then be contested by HMRC. Taxpayers who are unaware of the issue will not even have that choice. They can be expected to follow the guidance unaware of the risk that in so doing they may be found to have accounted for tax incorrectly.
- 2.7 This paper therefore supports calls for a review of the application of the ultra vires rule to be undertaken. Options would include:
 - 2.7.1 introducing the ability of the courts to award compensation to the person who had relied on the statement;
 - 2.7.2 making clearer the ability of the courts also to weigh up the interest of the individual in relying on the statement against the public interest of not permitting public authorities to exceed their powers when deciding whether a legitimate expectation may be enforced;
 - 2.7.3 giving taxpayers a clear statutory right to rely on guidance or specific forms of guidance.
- 2.8 If carrying out the statement would be lawful but HMRC decides no longer to follow the statement, generally the tipping point for the balance to come down

² For example, the guidance issued by HMRC in relation to Section 16A TCGA 1992 as discussed further in T. Bowler et al., 'Countering tax avoidance in the UK: which way forward?', TLRC Discussion Paper no. 7, 2009 (<http://www.ifs.org.uk/comms/dp7.pdf>).

in favour of the taxpayer is for the court to conclude that ‘the unfairness’, of which the taxpayer complains, renders the insistence by HMRC on performing its duties or exercising its powers an abuse of power by HMRC. This is the basis for the legitimate expectation doctrine. Although, in theory, it is possible to bring a legitimate expectation claim without the taxpayer having relied on the exercise of discretion to their detriment, cases where detrimental reliance can be shown are more likely to be successful.

- 2.9 In general, the hurdles for the taxpayer to succeed in a legitimate expectation claim are set high and a balancing act takes place; weighing up factors such as how unambiguous the statement is, whether the representation was made to an individual or specific group, and whether there has been detrimental reliance, against the greater public interest issues (such as consistency of treatment of all taxpayers) of enforcing the legitimate expectation.
- 2.10 The various forms of HMRC statement and practice have the potential to give rise to different levels of legitimate expectation. A specific and unambiguous clearance following a letter setting out all the relevant facts can be relied upon by the taxpayer concerned. In practice, the courts have been wary of straying beyond that to hold HMRC to statements made more generally.
- 2.11 Legitimate expectation is also enforced in relation to practice. The extent of that practice and the time period over which it has occurred will be relevant factors to be taken into account.
- 2.12 A published statement applying to a specific group of taxpayers can be changed by HMRC but the group has the right to rely on the statement until notified of the change or that the statement is withdrawn. It is not unreasonable to expect that publications designed to be ‘guidance’ by HMRC (in contrast to Manuals, which are designed for internal HMRC purposes) should be capable of being relied upon. In consequence, it would also be reasonable to expect that if the guidance needs to change because of changes in HMRC’s interpretation of the law, then this should be made clear. Does this mean that the onus should be on HMRC to withdraw guidance and/or to amend it if there is a change in law, whether as a result of a court judgment or legislative change? Although keeping guidance up to date requires the use of limited HMRC resources, the complexity of the UK tax system means that it is unrealistic to expect individual unrepresented taxpayers, at least, to be aware of such changes and their consequences. The paper encourages debate of where the line should be drawn between imposing extra burdens on HMRC and taxpayers. The level of expertise and resources of the taxpayer may be factors that should be taken into account.

- 2.13 The courts have shown little willingness to apply the legitimate expectation doctrine to Manuals. This is particularly the case for represented taxpayers. Recognition may be needed that Manuals are no more than statements of HMRC's view of the law, and that this view may change. This view may also be based on a particular set of circumstances and a small variation in these circumstances may give rise to different tax results. However, clarification of the role of the HMRC Manuals is needed. Although there are 'health warnings' contained in the Manuals, and in particular the introduction setting out how to use the Manuals,³ these are not always apparent. In addition, HMRC refers taxpayers to the Manuals for guidance without clear warnings that the views in the Manuals cannot automatically be relied upon. It may be that the Manuals should be recognised as being no more than publicly available copies of HMRC's own internal guidance, which are solely informative as to the approach HMRC will generally take, but this message is not currently clear and it is not a message consistently applied by HMRC itself.
- 2.14 A positive step forward would be for a basis to be agreed, on which various forms of HMRC guidance could be used and relied upon.
- 2.15 As a practical matter, it would assist taxpayers and their advisers if all guidance and statements (including Manuals) were to be clearly dated. Once superseded, the previous version should remain accessible.
- 2.16 Developments by HMRC, such as call centres, have limited use if the taxpayers using them cannot rely on the guidance given, as seems to be the case under current law. It may be the case that a taxpayer would be able to claim that they had a reasonable excuse for accounting for tax in the way they had, but that would only help with penalties. However, the development of on-line tools such as the Employment Status Tool,⁴ which are expressly stated to produce statements capable of being relied upon, is a positive step. The increased use of the internet rather than call centres may therefore offer a way forward.
- 2.17 The practical limits which a taxpayer faces in seeking judicial review of HMRC's statements or practice means that suggestions that more use should be made of guidance rather than detailed legislation are fraught with potential difficulties, even where such guidance is not ultra vires. This appears to have been recognised in the recently introduced General Anti-Abuse Rule ('GAAR'), which introduces a new category of 'approved' guidance and which opens up the possibility of taxpayers enforcing guidance through the appeal procedure rather than judicial review. If Parliament decides to leave important

³ See <http://www.hmrc.gov.uk/manuals/advisory.htm>.

⁴ See <http://www.hmrc.gov.uk/calcs/esi.htm>.

elements of legislation to be dealt with by HMRC guidance, then this approach could be extended to those occasions. Parliament would then actively be deciding to delegate that power to HMRC and taxpayers could clearly rely on the resulting guidance.

- 2.18 Even if a taxpayer is able to seek judicial review of HMRC's actions, the process is cumbersome and the interaction with the appeals system is difficult. The tax tribunals have wrestled with questions as to the jurisdiction of the First-tier Tribunal ('FTT') to consider legitimate expectation claims. Although it appears clear that the FTT does not have jurisdiction to hear judicial review claims, there is some uncertainty as to the extent to which a purported legitimate expectation can be taken into account in considering a substantive appeal. In cases where there is both a substantive appeal and a claim for judicial review, it is still not clear which should be considered first.
- 2.19 The time is therefore ripe not only for the extent to which taxpayers can rely on HMRC statements to be clarified, but also for there to be consideration of how those rights should be enforced. One way forward may be for taxpayers to be given clear rights to seek review in the FTT or directly to the Upper Tribunal. Alternatively, taxpayers could be given specific rights, which could be enforced through the FTT. Such powers could be based on a taxpayer contract setting out the principles for the use of HMRC's discretionary powers. This could be as part of the Taxpayers' Charter.
- 2.20 However, there will still be many cases, particularly smaller ones, where appealing to a Tribunal is too formal, expensive or time-consuming. Although there is currently an Adjudicator to whom cases can be referred, this is a lengthy process, the Adjudicator's powers are limited and, primarily, the Adjudicator is concerned with process. Another process involving Contentious Issues Panels is also not designed to deal with these sorts of complaints.
- 2.21 It would be better if in the first place a quick, efficient complaints process were in place, where the circumstances in which a taxpayer could rely on advice are known. An appropriate way to take that forward may be for HMRC to consult with interested taxpayer representative bodies to develop the current complaints process, perhaps in the context of making provision for taxpayers' rights in this area under the Taxpayers' Charter. Consideration could be given to distinguishing between the rights of represented and unrepresented (non-expert) taxpayers. In the latter case, there are good arguments that the balance should be tilted more in their favour if they have relied on HMRC guidance.

3 Background

- 3.1 In a complex tax system such as the UK's, there are many situations where tax law may be uncertain in its application, or where the interaction of various

rules leads to unexpected consequences. The interpretation of the law by the courts can produce further uncertainty. Court decisions can also produce conclusions at variance with accepted practice and which can affect how an entire sector of the economy functions. For example, the case of *HSBC Holdings plc and The Bank of New York Mellon Corporation v HMRC*⁵ concluded that holders of the American Depositary Receipts ('ADRs') issued under New York law did not hold a beneficial interest in the underlying shares. This could have had far-reaching consequences for the market in ADRs. However, HMRC issued a Revenue and Customs Brief confirming that for tax purposes, a holder of ADRs would continue to be treated as the beneficial owner of the underlying shares. HMRC's statement ensured that the ADR market could continue operating.

3.2 It is unrealistic to expect any tax system to operate without the taxing authority being given some discretion as to the application of the system. So, it is recognised that HMRC needs discretion to administer the tax system. While it is an accepted principle in the UK that the only body with power to levy taxation is Parliament,⁶ in doing so Parliament nevertheless confers various discretionary powers on HMRC. On the assumption that Parliament cannot (and should not) delegate its power entirely, the relevant questions are how far should HMRC's discretion go and how should it be controlled?

3.3 At present, HMRC's discretionary powers can be split into broadly three areas, as follows.

3.3.1 Specifically conferred administrative discretion: a specific power recognised in legislation to exercise some discretion in administering some aspect of the tax system; for example, whether to extend a company's time limits for claiming group relief; or whether to impose a penalty and to determine the amount of the penalty.

3.3.2 Specifically conferred discretion in levying taxation: discretion conferred by Parliament as a specific part of a taxing provision; for example, the discretion to determine whether a section may be relied upon when a taxpayer takes advantage of a statutory clearance procedure.⁷

The cases of specific discretion operate within specific legislative parameters set by Parliament.⁸

⁵ [2012] UKFTT 163 (TC).

⁶ Bill of Rights 1689.

⁷ For example, Section 215 Taxes Act 1988.

⁸ In some cases, such as extending the time limits for a group relief claim, it could be said that there is no real discretion. If the facts fall within the legislative parameters, then the extension is permitted.

- 3.3.3 General discretion: discretion conferred by Section 9 of the Commissioners of Revenue and Customs Act 2003. The Commissioners are made responsible for the collection and management of revenue and in order to carry out this function, the Commissioners may do anything which they think necessary or expedient in connection with the exercise of their functions, or incidental or conducive to the exercise of their functions.⁹ It is pursuant to this general discretion that HMRC publish extra-statutory concessions, statements of practice and a variety of other technical guidance, as well as agreeing to issue non-statutory rulings and clearances in particular circumstances.
- 3.4 Each of these three categories has been part of the tax system for many years. The issues that they raise are therefore not new. It is the extension and broadening, year by year, of their use that is the cause for the current enquiry. There are numerous examples in the changes made or proposed in 2014 alone. For example, changes were made in the Finance Act 2014 to the complex controlled foreign companies regime, including the introduction of another motive-based test. The approach adopted was for the wide ranging rules to be introduced in legislation and for HMRC to provide guidance notes and to offer non-statutory clearances or ‘low-risk indications’.¹⁰ Significant extensions of HMRC’s specific administrative discretion were also included in the Finance Act 2014, including the discretion to issue accelerated payment notices to taxpayers.¹¹ Although draft legislation has not yet been published, the highly contentious direct recovery of debts provisions, which have been the subject of consultation this year,¹² would also presumably be framed as specific administrative discretions.
- 3.5 As the same time, there have been some innovations in the way in which discretion has been conferred on HMRC, which seem to take discretionary powers to a new level. The first is found in the adoption of the GAAR in the Finance Act 2013. HMRC publishes guidance regarding the application of the GAAR in much the same way as it would publish guidance regarding the application of other tax law. However, in this case, the guidance is specifically contemplated by statute and it is subject to the approval of the GAAR panel. There is also discretion conferred on HMRC to decide whether to invoke the

⁹ Section 51(3) Commissioners of Revenue and Customs Act 2005 makes clear that the 2005 power is to be interpreted in the same way as previous references to ‘responsibility for care and management of the revenue’ in earlier legislation.

¹⁰ Sections 293–294 FA 2014.

¹¹ Section 219 Finance Act 2014.

¹² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/309624/Direct_Recovery_of_Debts.pdf.

GAAR and this is subject to specific statutory safeguards involving the GAAR Panel.¹³

- 3.6 Similarly, the Finance Act 2014 provisions dealing with strengthening the Code of Practice on banks give HMRC the interpretative discretion not only to determine what Parliament's intention is in legislation, but also to have the discretion to name and shame taxpayer banks who take a contrary view of Parliament's intention, subject in that case to the statutory safeguard of an 'independent reviewer'.¹⁴
- 3.7 In order to challenge HMRC's use of its discretionary powers (save where the statute confers specific appeal rights), taxpayers must usually apply for judicial review of the relevant action.¹⁵ Over many years, the courts have set out the parameters within which it is considered appropriate for the judiciary to consider the validity of actions by public bodies where judicial review of an action is sought. Broadly speaking, those parameters seek to identify when the action of a public body amounts to an abuse of power. In the context of taxpayers' dealings with HMRC, one of the primary concerns of recent years has been to decide when HMRC should be bound by statements it makes. The various forms of HMRC statement regarding the interpretation of tax law cover a wide range of material: assurances given to particular taxpayers or taxpayer representative bodies, non-statutory clearances, Extra Statutory Concessions, Statements of Practice, HMRC's Manuals, guidance notes, tax guides, briefing notes and bulletins. Most of these are now available on-line to both advisors and taxpayers alike. The major exceptions are taxpayer specific assurances and clearances and those generated through interactions between HMRC and representative bodies. In the latter case, the material may be available to members of the body concerned or more generally if published by the body. As the amount, variety and scope of this material increases, so it becomes increasingly important to know when it is an abuse of HMRC's discretionary powers for HMRC to act contrary to a previous statement. Material published by other persons (such as representative bodies) raises the further question of whether and to what extent it is actually endorsed by HMRC and can be relied upon against HMRC.
- 3.8 The courts have developed a doctrine of 'legitimate expectation' in considering such issues in the context of the powers of public bodies generally and not just HMRC. This paper briefly sets out the relevant parameters of that doctrine as developed in general administrative law (recognising that this is a huge area of

¹³ Ultimately invoking the GAAR, where this is disputed by the taxpayer, will result in an appeal by the taxpayer to the Tribunal. It could be said that invoking the GAAR involves no more discretion than the decision to apply any other statutory provision.

¹⁴ Sections 285–288 FA 2014.

¹⁵ As confirmed by the case of *HMRC v Mitesh Dhanak* [2014] UKUT 0068 (TCC), discussed further below.

law from which the paper can only extract the core points here), before considering how the courts have applied this to HMRC. This leads on to consideration of the practical implications of the application of the doctrine to HMRC's actions.

- 3.9 However, the problems in relying upon statements made by HMRC or attributed to HMRC are not derived purely from the detail of the legal rules but also from the procedural difficulties faced by taxpayers. The paper considers those difficulties and the practical implications for the relationship between taxpayers and HMRC and then how the system could be modified to deal with the identified problems.

4 The Development of the Legitimate Expectation Doctrine in General Administrative Law

- 4.1 Judicial review is the process by which maladministration by any administrative authority is generally challenged. There are a range of grounds for judicial review that have been developed by the courts, predominantly in the 20th century, building on earlier legal processes. One of the more recent developments has been that of the doctrine of legitimate expectation as one basis on which administrative authorities can be bound to their statements or actions through the process of judicial review. What can sometimes be forgotten when considering the application of legitimate expectation to tax cases is that HMRC is one of many administrative authorities and the doctrine that has developed is not a 'tax' doctrine but one of general administrative law. Therefore, the application of the doctrine to date needs to be considered in that more general context first in order to understand the principles, which are then applied to HMRC as to other public bodies.

- 4.2 The courts have had to negotiate a fine balancing act between various principles of administrative law as these principles have developed. The principles may, at times, limit what a public body can do and/or give individuals rights in relation to the acts of those bodies. However, at other times, those same principles may limit the ability of an individual to challenge the public body's acts. A full analysis of judicial review and the developing doctrines in that area of law is beyond the scope of this paper. However, the key principles for the purposes of this paper are:

- 4.2.1 the ultra vires rule, where a power vested in a public body is exceeded, and acts done in excess of the power are invalid as being ultra vires;
- 4.2.2 the rule that an authority which is entrusted with a discretion must direct itself properly on the law or its decision may be declared invalid;

- 4.2.3 the rule that public bodies may not fetter their own discretions, and thus a body must not contract in advance to exercise a power in a particular way;
 - 4.2.4 the rule that the courts may not put themselves in the position of having to exercise the discretions of administrative bodies;
 - 4.2.5 notions of fairness, including what is referred to as the doctrine of legitimate expectation.
- 4.3 In 1905, it was stated that ‘a public body invested with statutory powers ... must take care not to exceed or abuse its powers. It must keep within the limits of the authority committed to it. It must act in good faith. And it must act reasonably.’¹⁶
- 4.4 The courts have been most ready to decide in favour of an applicant where the applicant asks the court to exercise control of a public body by preventing the body from acting in a way which would exceed its powers (rather than perpetuating the ultra vires act). Going beyond that position was to risk breaching, for example, the principle that public bodies may not fetter their own discretion or the principle that the courts may not exercise the administrative discretion that has been conferred on a public body.
- 4.5 However, during the latter part of the 20th century the courts appeared to weave their way through what could at times be apparently conflicting principles, by developing one particular aspect of the notions of fairness: the doctrine of legitimate expectation. The legitimate expectation must be such that it would be an abuse of power for the public body to resile from the matter in respect of which it has allowed a statement to be made.¹⁷ Indeed, notions of fairness in a judicial context do not simply require courts to ask: is it fair to allow the authority to change its decision or practice? Fairness is the act of balancing the potentially conflicting interests of the individual and the administrator.
- 4.6 The balancing act between the principles can be difficult at times. For example, it may seem unjust for a person who has erected a building in the belief, induced by a planning authority official, that everything was in order to then be told by the authority to take the building down because the official had no power to grant permission. On the one hand, if the authority is held to the official’s approval, does this breach the ultra vires principle by allowing the authority to extend its powers by making representations that it does not have the power to make? On the other hand, should not the individual be able to rely on the statements made by the official? This was the situation considered in the

¹⁶ Per Lord McNaughten in *Westminster Corporation v London and North Western Ry.* [1905] AC 426.

¹⁷ In *re Preston* [1985] AC 835. At 851H per Lord Scarman, 864G-867A per Lord Templeman; *ex parte Coughlan* paragraphs 67–71.

case of *Lever Finance Ltd v Westminster (City) London Borough Council*¹⁸ where the Court of Appeal held that the council was bound by the statements made by the planning official and the building stayed, even though the neighbours felt justifiably aggrieved that the permission should never have been granted. ‘If an officer, acting within the scope of his ostensible authority, makes a representation on which another acts, then a public authority may be bound by it, just as much as a private concern would be.’¹⁹

4.7 In balancing all the factors and principles involved, it is necessary to consider whether the statement was ultra vires. Where a public authority makes a representation that it has no power to make or that would lead to a conflict with its statutory duty, the representation will not generate an enforceable legitimate expectation.²⁰ This can have significant impact. An authority can, in effect, walk away from a statement without any liability to those who had relied upon the statement, if that statement or the carrying out of it would be ultra vires. This principle will be returned to throughout this paper and has significant implications for the relationship between HMRC and taxpayers. It may be noted, however, that it is the subject of considerable criticism, not least in the courts. In the Court of Appeal, in one of the leading non-tax legitimate expectation cases Lord Justice May said ‘This is unjust and illustrates a defect in the law.’²¹

4.8 The doctrine of legitimate expectation is a developing area of law. As Lord Justice Laws put it: ‘I acknowledge that much of the ground is at the foothills. But the path falters a little further up.’²² The early cases considering legitimate expectation (including the *Lever Finance* case) characterised the rights resulting as rights equivalent to the private law right of estoppel. Others categorised them as something akin to moral obligations rather than private law rights. Over the past 50 years, the rights have strengthened and have been treated as public law rights in and of themselves, not based on the private law rights of contract or estoppel. One of the most authoritative commentators in this area says that ‘the protection of legitimate expectations is at the root of the constitutional principle of the rule of law, which requires regularity, predictability, and certainty in the government’s dealings with the public.’²³

¹⁸ [1971] 1 QB 222.

¹⁹ Ibid per Lord Denning.

²⁰ In *Rowland v Environment Agency* [2003] EWCA Civ 1885.

²¹ Ibid at paragraph 103.

²² *R (Bhatt Murphy (a Firm)) v Independent Assessor* [2008] EWCA Civ 755.

²³ *DeSmith’s Judicial Review* (6th edn, 2007), paragraph 12-001. See also P. Craig and S. Schönberg, *Substantive Legitimate Expectations after Coughlan* [2000] PL 684, 696–697.

- 4.9 In 2001, in the case of *R v North and East Devon Health Authority, ex parte Coughlan*,²⁴ the court set out a statement of where the doctrine of legitimate expectation had reached:

‘(a) The court may decide that the public authority is only required to bear in mind its previous policy or other representation, giving it the weight it thinks right, but no more, before deciding whether to change course. In that case the court is confined to considering whether the authority is acting in such a way that no reasonable authority could be expected to.

(b) The court may decide that the promise or practice induces a legitimate expectation of, for example, being consulted before a particular decision is taken. Here ... the court itself will require the opportunity for consultation to be given unless there is an overriding reason to resile from it in which case the court will itself judge the adequacy of the reason advanced for the change of policy, taking into account what fairness requires.

(c) Where the court considers that a lawful promise or practice has induced a legitimate expectation of a benefit which is substantive, not simply procedural, ... the court will ... decide whether to frustrate the expectation is so unfair that to take a new and different course will amount to an abuse of power. Here ... the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy

In the case of the first, the court is restricted to reviewing the decision on conventional grounds. The test will be rationality and whether the public body has given proper weight to the implications of not fulfilling the promise. In the case of the second category the court’s task is the conventional one of determining whether the decision was procedurally fair. In the case of the third, the court has when necessary to determine whether there is a sufficient overriding interest to justify a departure from what has been previously promised.’

- 4.10 So, a distinction has been drawn between cases involving procedural expectation and substantive expectation but, throughout, the underlying question continues: would it be an abuse of power for the public authority to resile from the matter in respect of which it has allowed a legitimate expectation to arise?²⁵ Proportionality is seen as key. So: ‘where the representation relied on amounts to an unambiguous promise; where there is detrimental reliance; where the promise is made to an individual or specific group; these are instances where denial of the expectation is likely to be harder to justify as a proportionate measure ... On the other hand where the

²⁴ [2001] QB 213.

²⁵ In *re Preston* *ibid.*

government decision-maker is concerned to raise wide-ranging or “macro-political” issues of policy, the expectation's enforcement in the courts will encounter a steeper climb. All these considerations, whatever their direction, are pointers not rules. The balance between an individual's fair treatment in particular circumstances, and the vindication of other ends having a proper claim on the public interest (which is the essential dilemma posed by the law of legitimate expectation) is not precisely calculable, its measurement not exact These cases have to be judged in the round.’²⁶

- 4.11 Detrimental reliance does not always seem to be necessary though. In *R (Bancoult) v Secretary of State for Foreign and Commonwealth Affairs (No 2)*²⁷ Lord Hoffmann said: ‘It is clear that in a case such as the present, a claim to a legitimate expectation can be based only upon a promise which is “clear, unambiguous and devoid of relevant qualification” ... It is not essential that the Applicant should have relied upon the promise to his detriment, although this is a relevant consideration in deciding whether the adoption of a policy in conflict with the promise would be an abuse of power and such a change of policy may be justified in the public interest, particularly in the area of what Laws LJ called “the macro-political field”.’ However, as Lord Justice Gibson stated in *R v Secretary of State for Education, ex parte Begbie*,²⁸ ‘...it would be wrong to understate the significance of reliance in this area of the law. It is very much the exception, rather than the rule, that detrimental reliance will not be present when the court finds unfairness in the defeating of a legitimate expectation.’
- 4.12 There is a generally acknowledged right that ‘a decision-maker must follow his published policy (and not some different unpublished policy) unless there are good reasons for not doing so.’²⁹ The question whether the public authority may lawfully resile from a legitimate expectation will be particularly fact-sensitive, depending on factors such as the strength of the expectation, the subject matter to which it relates and the consequences of giving effect to the change. The role of the court in such cases is therefore not so very different from the role it plays in other cases involving procedural fairness, where it is accepted that the requirements of fairness vary from case to case.³⁰
- 4.13 As Lord Justice Laws put it: ‘A very broad summary of the place of legitimate expectations in public law might be expressed as follows. The power of public authorities to change policy is constrained by the legal duty to be fair (and

²⁶ *Nadarajah v Secretary of State for the Home Department* [2005] EWCA Civ 1363.

²⁷ [2009] 1 AC 453.

²⁸ [2000] 1 WLR 1115 at 1124.

²⁹ See *R(Lumba) v Secretary of State for the Home Department* [2011] UKSC 12 at paragraph 26.

³⁰ *Lloyd v McMahon* [1987] AC 625, 702-703 per Lord Bridge; *R v Secretary of State for the Home Department, ex parte Doody* [1994] AC 531, 560 per Lord Mustill.

other constraints which the law imposes). A change of policy which would otherwise be legally unexceptionable may be held unfair by reason of prior action, or inaction, by the authority. If it has distinctly promised to consult those affected or potentially affected, then ordinarily it must consult (the paradigm case of procedural expectation). If it has distinctly promised to preserve existing policy for a specific person or group who would be substantially affected by the change, then ordinarily it must keep its promise (substantive expectation). If, without any promise, it has established a policy distinctly and substantially affecting a specific person or group who in the circumstances was in reason entitled to rely on its continuance and did so, then ordinarily it must consult before effecting any change (the secondary case of procedural expectation). To do otherwise, in any of these instances, would be to act so unfairly as to perpetrate an abuse of power.³¹

4.14 Therefore in summary, the following principles have been articulated by the legitimate expectation cases.

4.14.1 There may be substantive or procedural legitimate expectation.

4.14.2 In considering whether the representation by the public body can be enforced, it is necessary to consider: (i) how unambiguous the statement is, whether the representation was made to an individual or a specific group, and whether there has been detrimental reliance; (ii) the extent to which the administrator's change of view or practice raises greater public interest issues. (i) and (ii) need to be weighed up against each other to determine whether the legitimate expectation should be enforced. If the statement or the carrying out of it would be ultra vires, then the factors in (i) will not overcome that public interest issue.³²

4.14.3 If, without a specific commitment, the distinct and substantial policy affects a person or group who was entitled to rely on it, then that person or group should be consulted before the policy is changed.

4.14.4 Individual officers of a public body acting within their ostensible authority can bind the authority.

4.15 It is clear from the numerous cases in this area that a claim to rely upon legitimate expectation requires a detailed balancing of all the relevant factors. Cases that may appear inconsistent can usually be explained on the basis that in weighing up the different factors, the balance tips one way or the other according to the underlying findings of fact.

³¹ *R(Bhatt Murphy (a Firm)) v Independent Assessor* ibid.

³² There have been exceptions to this proposition when human rights were involved.

5 The Application of the Legitimate Expectation Doctrine in Tax Cases

- 5.1 Two issues need to be addressed in the context of tax cases: first, how do the rules described above apply in the context of the relationship between taxpayer and HMRC; and second, in which court and how, as a matter of legal process, can a taxpayer challenge HMRC's action?

Application of the principles in tax cases

- 5.2 The leading House of Lords case of *R v Inland Revenue Commissioners, ex parte Preston*³³ set out the parameters of the developing doctrine of legitimate expectation in relation to HMRC:

- 5.2.1 HMRC are not immune from the process of judicial review;
- 5.2.2 taxpayers are entitled to relief by way of judicial review for 'unfairness' amounting to abuse of power if HMRC has been guilty of conduct equivalent to a breach of contract or breach of representations;
- 5.2.3 the court can intervene by judicial review to direct HMRC to abstain from performing its statutory duties, or from performing its statutory powers, or from exercising its statutory powers, if the court is satisfied that 'the unfairness' of which the taxpayer complains renders HMRC's insistence on performing its duties or exercising its powers an abuse of power by HMRC.

- 5.3 Following other cases, the application of the legitimate expectation doctrine to tax cases developed as follows.

- 5.3.1 If the taxpayer puts all his cards upwards on the table by setting out all relevant facts and by making it clear what ruling is sought, and if HMRC gives a ruling that is clear, unambiguous and devoid of relevant qualification, then the taxpayer is entitled to rely on the ruling.³⁴
- 5.3.2 Statements or agreements of HMRC that are ultra vires cannot give rise to a legitimate expectation that those statements or agreements will be perpetuated indefinitely, although it may be possible to bind HMRC for the past where the taxpayer has relied upon the statements of HMRC and, in some cases, for a limited period in the future.³⁵ After the case of *R v HMRC, ex parte Wilkinson* considered below, this was taken by HMRC to mean also that Extra-Statutory Concessions (ESCs), which could not be brought within any reasonable articulation of the general

³³ [1985] 1 AC 835.

³⁴ *R v Inland Revenue Commissioners, ex parte MFK Underwriting Agents Ltd* [1990] 1 WLR 1545.

³⁵ *Al Fayed and others v Advocate General for Scotland (representing the Inland Revenue Commissioners)* [2004] STC 1703; *R (GSTS Pathology LLP) v HMRC* [2013] EWHC 1801 (Admin).

collection and management discretion, were therefore ultra vires and so invalid.

5.3.3 HMRC may issue various materials which set out their interpretation of the law. These statements do not change the law or usurp the courts' role in interpreting the law.³⁶

5.3.4 If HMRC gives a taxpayer a clear and unambiguous ruling on the basis of full disclosure of the relevant facts, then HMRC should not generally be permitted to deny that treatment retrospectively, but may do so prospectively if reasonable notice is given to the taxpayer.

5.4 Two primary questions therefore arise. What are the implications of the ultra vires rule on HMRC's exercise of its administrative powers? If HMRC acts within its powers to exercise its discretion, when can that exercise be relied upon by taxpayers?

The ultra vires rule

5.5 In the Court of Appeal case of *F&I Services Ltd v Customs and Excise Commissioners*,³⁷ responding to the assertion that the 'mere' fact that advice turns out to be wrong in law does not by itself entitle HMRC to go back on it, Lord Justice Sedley said 'There is nothing "mere" about official advice which is wrong in law. At least if the taxpayer relies on it. It is of course serious for the taxpayer; but it is serious for the public and for the rule of law ... [It is] absolutely clear that the law recognises no legitimate expectation that a public authority will act unlawfully.'

5.6 The fact that HMRC cannot be required to act unlawfully has clear implications for the enforcement of statements made by HMRC. In the context of individual rulings, a distinction has been drawn between HMRC being held to agreements regarding the past and HMRC being held to agreements regarding the future. If HMRC considers that the public interest will be better served by compromise regarding the treatment of previous transactions and the amount of tax to be paid, then that conclusion is within its general care and management discretion.³⁸ However, it was held in the case of *Al Fayed and others v Advocate General for Scotland (representing the Inland Revenue Commissioners)*³⁹ that there was no power for HMRC to bind itself as regards future liability. This was confirmed in the recent case of *Southern Cross Employment Agency Ltd v The Commissioners for HMRC*,⁴⁰ which illustrates

³⁶ *Campbell Connelly & Co Ltd v Barnett (Inspector of Taxes)* [1992] STC 316.

³⁷ [2001] STS 939.

³⁸ *IRC v Nuttall* [1990] STC 194.

³⁹ [2004] STC 1703.

⁴⁰ [2014] UKFTT 088 (TC).

the limitations applied to the ultra vires rule for HMRC agreements regarding the past. Even though it turned out that the taxpayer had no entitlement to the VAT it had claimed, and on the basis of which a compromise agreement was reached, this was because a court case after the agreement had decided the correct treatment of the VAT. Therefore, the fact that the agreement was made on the basis of an incorrect view of the law could only be known with the benefit of hindsight. If such an agreement was later found to be ultra vires, then ‘it would render HMRC’s power to compromise claims virtually worthless’⁴¹.

- 5.7 The case of *F&I Services* was concerned with reliance on statements regarding an ongoing taxpayer practice. A VAT clearance for a voucher scheme was withdrawn following a change in view of Customs & Excise as to the operation of the law. The taxpayer had incurred expense on the introduction of the scheme. Lord Justice Sedley stated that ‘the law recognises no legitimate expectation that a public authority will act unlawfully. It is only where the expectation is of a particular exercise of managerial discretion that the court will begin to examine its legitimacy.’ So if a taxpayer is seeking to rely on guidance in relation to a continuing state of affairs, the taxpayer is exposed to changes in that guidance where HMRC considers that changes are necessary to comply with the law.
- 5.8 The ultra vires principle is not only relevant to specific guidance given to individual taxpayers. In the case of *R v HMRC, ex parte Wilkinson*,⁴² the House of Lords set out the scope of HMRC’s general management and collection discretion pursuant to which HMRC operates ESCs as well as guidance in many different forms. Lord Hoffmann described that HMRC discretion in the following way: ‘This discretion enables the commissioners to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of Parliamentary time.’ That is a relatively narrow ambit. In the case concerned, the taxpayer who was a widower was seeking, on a concessionary basis, the same allowance as that available under statute for widows. The legislation only provided for the allowance to be available to widows and although this arguably resulted in hardship for widowers, this was not a matter which HMRC had the power to remedy.
- 5.9 It was accepted, however, that HMRC could settle another case by repaying tax where the taxpayer was taking the same point of discrimination to Strasbourg. That settlement of litigation instituted by one taxpayer did not place HMRC

⁴¹ Per Judge Berner at paragraph 67.

⁴² [2005] UKHL 30.

under an obligation to treat taxpayers who had not instituted litigation in the same manner. Such a discretion falls within what Lord Diplock described as the ‘wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, the highest net return that is practicable having regard to the staff available to them and the cost of collection’.⁴³

- 5.10 After the *Wilkinson* case, in which Lord Hoffmann stated that HMRC’s discretion does not ‘enable the commissioners to concede by extra-statutory concession, an allowance which Parliament could have granted but did not grant’, HMRC reviewed all ESCs and embarked on a process of withdrawing those which it considered had breached this principle. Where appropriate, concessions have been incorporated into tax legislation by Parliament. Arguably some remain which are beyond the narrow confines of the management and collection discretion described by Lord Hoffmann. However, the same ultra vires rules apply to other forms of HMRC statement and guidance and the implications of this are considered further later in the paper.

Discretionary acts that are not ultra vires

- 5.11 Assuming that the statement or practice is within HMRC’s powers, when can that statement or practice be relied upon? One of the key elements for enforceability of a legitimate expectation appeared to be a clear, unambiguous statement, devoid of qualification, following full disclosure of the relevant facts by the taxpayer. In essence, the cases had focused on what was described above as ‘substantive expectation’.⁴⁴ However, the case of *R v Inland Revenue Commissioners, ex parte Unilever*⁴⁵ showed that it could also be possible to enforce a long-standing practice or course of conduct. This was a tax case involving procedural expectation. The Revenue refused a claim from Unilever to a tax benefit on the grounds that it was made outside the two-year statutory time limit, despite the fact that the Revenue had established a practice of not enforcing the limit; they had allowed late claims 30 times over a period of 25 years. The Court of Appeal held that the refusal was unlawful in the circumstances. A long-standing practice of HMRC could be struck down for substantive unfairness, but only if it was ‘so unfair as to amount to an abuse of power’. Thirty claims over 25 years meant that the practice could be relied upon. Fewer claims over a shorter period presumably would have been more difficult to rely on. This comes back to the point made above that the courts have to perform a balancing act that depends on all the facts.

⁴³ In *R v Inland Revenue Commissioners, ex parte National Federation of Self-Employed and Small Businesses Ltd* [1982] AC 617 at 636.

⁴⁴ See paragraph 4.9 above.

⁴⁵ [1996] STC 681.

- 5.12 In the FTT case of *Patel v CRC*,⁴⁶ the balancing act was not so difficult. Mr Patel claimed to set Enterprise Zone allowances against earnings from a profession for National Insurance liability, even though it was accepted that there was no statutory basis to do so. Mr Patel's advisor claimed, without citing any examples, that he had done so successfully for other clients. It was not surprising that the Tribunal concluded that Mr Patel had not suffered any loss by not being given a supposed tax treatment which was not in accord with statute where there was no evidence of such a treatment being given.
- 5.13 Reliance on a telephone conversation with HMRC is also likely to be difficult. In *Corkteck Ltd v Her Majesty's Revenue and Customs*,⁴⁷ Mr Justice Sales had to consider whether or not a legitimate expectation had been established as a consequence of a telephone conversation that took place between the taxpayer and an agent of HMRC's telephone national advice service. The judge heard oral evidence about the conversation and resolved that the taxpayer's account was not reliable, so the statements in the case are not strictly binding to other cases. However, he analysed and applied the judgment of the Divisional Court in the *MFK Underwriting Agencies Ltd*⁴⁸ case. He drew attention to the requirement that the taxpayer should provide to the tax official the full details of the specific issue or transaction upon which he sought guidance and said: 'In my view, this aspect of the test in *ex p. MFK Underwriting Agencies Ltd* will be especially difficult to satisfy where the taxpayer claims that an enforceable legitimate expectation has arisen on the basis of a purely oral exchange with a tax official. In particular, where there is no written request for a tax ruling, then in anything other than very exceptional circumstances a tax official will not have been on proper notice of the desire of the taxpayer to have a fully considered ruling on the point of issue and will not have been put on proper notice of the importance and significance of the ruling which he is being asked to provide.'
- 5.14 However, it is interesting to note the warning given to HMRC in the context of telephone calls made where the caller cannot be expected to be a person with significant knowledge of the tax system, in the case of *Watson v HM Customs & Excise*,⁴⁹ where the Tribunal said: 'We regard it as essential for the Commissioners to inform those making enquiries of this type that they should write to ask for written confirmation of the position as discussed in the course of the telephone conversation. Those who are within the VAT system are expected to be aware that such written confirmation is necessary; it is expecting too much of do-it-yourself builders, who are not part of the normal

⁴⁶ [2011] UKFTT 373 (TC).

⁴⁷ [2009] EWHC 785 (Admin).

⁴⁸ *R v Inland Revenue Commissioners, ex parte MFK Underwriting Agents Ltd* [1990] 1 WLR 154.

⁴⁹ (2004) (VAT 18675).

VAT system, to be aware of this without it being specifically pointed out to them by the Commissioners.’

- 5.15 The Tribunal also criticised the lack of clarity in the relevant VAT Notice sent to the taxpayer to explain the VAT treatment and in the internal Customs guidance on the issue, which had also been sent to the taxpayer. Notwithstanding the fact that this was an individual who would not be expected to have the same knowledge of the VAT system as the average business, and the lack of clarity of materials sent to the taxpayer, the taxpayer still lost their appeal against the VAT charge. The taxpayer had not relied on a clear unambiguous statement – there was therefore no basis to run a legitimate expectation argument. The taxpayer needed to write to HMRC setting out the facts so that HMRC could provide a clear and unambiguous statement. Considering the factors which the general administrative law cases have said should be weighed up in order to assess the application of the legitimate expectation doctrine (see paragraph 4.14), it appears that the extent to which the statement was unambiguous was of paramount importance, despite the taxpayer’s lack of technical knowledge.
- 5.16 It is important for taxpayers to be aware of the need for the right process to obtain binding guidance from HMRC. In a recent VAT case, it was made clear that self-assessment systems impose an onus on the taxpayer to get his tax returns correct.⁵⁰
- 5.17 In *Oxfam v HMRC*,⁵¹ the taxpayer had entered into an agreement with HMRC but the court’s decision illustrates how agreements with a public body cannot be set in stone. They are susceptible to change as the law changes. Otherwise it could be argued that HMRC is usurping the role of the courts to determine the application of the law. In addition, in *Oxfam*, the court showed it is not prepared to allow the taxpayer a windfall from an agreement where the underlying rules change. That in itself is not ‘fair’. When the factors summarised in paragraph 4.14 above were weighed up, the taxpayer’s claim to legitimate expectation was not strong enough.
- 5.18 The question in the case was whether Oxfam could rely on an agreed formula when applying apportionment for VAT. Oxfam had entered into an apportionment agreement with HMRC but a case changed the understanding of the apportionment rules. Following the case, Oxfam’s recovery rate using the previous formula would increase significantly. HMRC issued a Business Brief regarding the case law implications. Oxfam continued to make a claim on the originally agreed basis and HMRC refused it. The court considered that the

⁵⁰ *Anderson v Commissioners for Her Majesty’s Revenue and Customs* [2010] UKFTT 432 (TC).

⁵¹ [2009] EWHC 3078 (CH).

question was whether Oxfam's apportionment agreement gave rise to a substantive legitimate expectation (applying the *ex p. Coughlan* analysis above). Oxfam's claim that it could rely on a legitimate expectation failed because the court found as a matter of fact that Oxfam had not relied on the agreement to its detriment. 'In a case such as this, involving an assurance given to only one person and where there is no irrationality on the part of the public authority in adopting a different approach, the absence of detrimental reliance on the part of the person to whom the assurance is given is fatal to the argument that to modify the assurance would involve an abuse of power on the part of the public authority which gave the assurance.'⁵²

- 5.19 In addition, Mr Justice Sales considered that other legitimate expectation factors led to the same conclusion. In particular, the agreed apportionment had been on a basis which had been based on a common mistake about the law. Therefore, there would not be an abuse of law to correct a mistake made by both parties. In addition, HMRC had acted properly and for a powerful overriding public interest in correcting the formula as it did. It was an important public interest that HMRC should seek to collect taxes in a way which achieved reasonable fairness between taxpayers, avoiding where possible unmerited windfalls for particular taxpayers.
- 5.20 The importance of detrimental reliance was highlighted by another High Court case, *R (GSTS Pathology LLP) v HMRC*.⁵³ The judge was prepared to give effect to a legitimate expectation where specific rulings had been obtained and the taxpayer had incurred considerable expenditure as a result of them. The rulings had been regarding the VAT treatment of certain medical services and HMRC had subsequently decided that its previous opinion was wrong.
- 5.21 Mr Justice Legatt summed up the problem faced when HMRC seeks to change a statement or practice as follows: 'On the one hand, it can be said that if the tax treatment stated by HMRC in a ruling to be correct can change – not as a result of any change in the law but just because HMRC has changed its view – the value of such rulings and the practice of giving them will be very substantially undermined. The taxpayer is surely entitled to expect consistency and not that a public authority will change its mind without any objective change in circumstances. The counter argument is that HMRC cannot reasonably be obliged to perpetuate indefinitely what is now considered to be a mistaken interpretation of the law. To do so would be inconsistent with its duty to collect what it believes to be the correct amount of tax required by law.'

⁵² Per Mr Justice Sales.

⁵³[2013] EWHC 1801 (Admin).

Where the balance is struck between these competing arguments may depend on the particular facts of the case.’⁵⁴

- 5.22 In that case, on those facts, the taxpayer had an enforceable legitimate expectation. The substantive legal question as to the VAT treatment of the medical supplies was being considered by the tax tribunal and Mr Justice Legatt considered that not only should the rulings apply to the past but should also apply for three months after the Tribunal case if the taxpayer’s case in that court was unsuccessful. In other words, even if the ruling was found to be wrong in law, the taxpayer should be given time to put their affairs in order.
- 5.23 Clearly, the full set of circumstances needs to be considered. The two cases of *Oxfam* and *GSTS Pathology* show that while, in theory, it may be possible to rely on legitimate expectation without detrimental reliance, in practice, in tax cases as in non-tax cases, detrimental reliance will make the arguments for the taxpayer much stronger.
- 5.24 Statements made in the *Oxfam* case regarding the status of Revenue Manuals, while not authoritative for other cases, are of interest. The court referred to the Manual guidance setting out how a taxpayer could seek agreement to a method of apportionment, but proceeded to state that ‘The agreement contemplated by this guidance is no more than HMRC indicating that it regards some method of apportionment proposed by the taxpayer as acceptable – the guidance does not refer to a binding, private law contract between HMRC and the taxpayer.’
- 5.25 The status of the HMRC interpretations set out in the Manuals was also considered in the case of *Hanover Company Services Ltd v HMRC*.⁵⁵ Hanover consulted their accountants who in turn relied on a Business Brief, a less technical VAT information sheet (which set out a ‘non-exhaustive’ list) and the HMRC Manual to confirm that Hanover had applied the right VAT treatment to a transaction. The Tribunal concluded that as Hanover had not consulted the materials but had relied on the accountants’ advice, Hanover did not itself rely on a practice of HMRC and therefore ‘it cannot be outrageously unfair for HMRC to have raised an assessment which is inconsistent with paragraph 9.5.4 of Manual V1-3’. The Tribunal noted that even if Hanover had relied on the Manual, it would not have given rise to a legitimate expectation as the representation was not devoid of relevant qualification (i.e. the Manual health warning which applied at the time).
- 5.26 As a legal matter, it would have been surprising for the Tribunal as first-tier court to have reached any other conclusion than the fact that there was not a clear and unambiguous statement devoid of qualification on which the

⁵⁴ See paragraphs 96–98 of the judgment.

⁵⁵ [2010] UKFTT 256(TC).

taxpayer could rely. This would be departing from the precedent of other cases, both tax and non-tax, and would have been stretching the doctrine of legitimate expectation significantly.

- 5.27 Another case to cause significant comment was the *Gaines-Cooper* case⁵⁶ where the Revenue guide to UK residence rules, IR20, was considered. The appellants organised their lives to fall within the ‘rules’ which they believed were set out in IR20. HMRC claimed that they should have made ‘a distinct break in the pattern of their life in the UK’ as a result of case law on the topic even though this was not expressly stated in IR20.
- 5.28 The Supreme Court majority decision was based on a construction of IR20 which their Lordships concluded did inform the ‘ordinarily sophisticated taxpayer’ that a distinct break was, in effect, required. Alternatively, if the leaflet did not lead to that conclusion it was so ‘unclear as to communicate to its readers nothing to which legal effect might be given’. In addition, the Lords found as a matter of fact that there was insufficient evidence that the practice of HMRC had changed over time. Consequently, this case can be limited in its scope to its facts and the construction of the majority of the court of IR20. This construction of IR20 (whether or not a construction with which others would agree) meant that little was added to the doctrine of legitimate expectation and it would not be difficult to distinguish this case in another situation where a taxpayer had relied on clear, unambiguous statements in guidance.
- 5.29 Such a case was more clearly apparent in *Cameron and others v Revenue and Customs Commissioners*.⁵⁷ In that case HMRC had published a concession regarding the taxation of seafarers. The concession had been published in a specific document aimed at seafarers known as the Blue Book. Mr Justice Wyn Williams was clear: ‘In my judgment the answer to these questions must be sought by reference to the manner and extent of the publication of the broad concession. The Claimants allege that the broad concession was published in a formal document produced by the Defendants (the Blue Book) which had as its aim the provision of assistance to seafarers who were contemplating making a claim for FED. The Blue Book was aimed at all those seafarers who were eligible, potentially, to claim FED. Assuming for the moment that the terms of the broad concession within the Blue Book were clear and capable of founding a legitimate expectation, my judgment is that the Defendants would remain bound by the broad concession until they had given notice to all seafarers potentially eligible to claim FED/SED that the concession was to be withdrawn or altered. It is not for me to lay down prescriptive rules about how such notice could be given. However, effective notice of a change could be given only if

⁵⁶ *R (on the application of Gaines-Cooper) v HMRC* [2011] 1 WLR 2625.

⁵⁷ [2012] EWHC 1174 (Admin).

there was publication in some form to the whole class of potentially eligible taxpayers’

5.30 In fact the judge went further, denying the ability of HMRC to escape being held to its statements by an Inspector writing to a taxpayer expressing a different view. He said: ‘If a taxpayer legitimately relies upon a statement made by the Defendants which is contained within a document published by the Defendants and aimed at a class of taxpayers of which the taxpayer is one it does not seem to me that his reliance upon the document ought to be regarded as unreasonable simply because an employee of the Defendant expresses a view which is contrary to that contained in the document. In my judgment a taxpayer is entitled to rely upon a statement made in a formal publication unless and until the statement is revoked, withdrawn or altered in the manner described.’

5.31 This does not mean that guidance cannot change, but there was a procedural legitimate expectation. A clear unambiguous statement can be changed if the appropriate level of notice is given to those who have previously been capable of relying on the statement. The case can be distinguished from the *F&I Services* case referred to above because in *F&I Services*, the clearance for an ongoing state of affairs was found to be ultra vires. In contrast, in the *Cameron* case there was no suggestion that the seafarers’ concession was ultra vires or wrong as a matter of law.

5.32 In conclusion, the ability of taxpayers to rely on statements that are ultra vires is limited. If a statement is not ultra vires, then there is still a range of occasions when HMRC uses its discretionary powers in ways in which taxpayers may want to rely upon, ranging from the cases where a taxpayer can point to a clear and unambiguous statement, following full disclosure of the facts, and on which they have relied, to broad statements of interpretation in the Manuals. In between lies a huge and growing middle ground. The practical problems with the application of the legitimate expectation doctrine to these varying situations are considered later in this paper.

The procedural problems

5.33 Aside from the difficulties with the substantive rules regarding legitimate expectation, there are also considerable procedural hurdles for taxpayers. A case based on legitimate expectation requires an application to be made for judicial review of the action of the public body. In general, the expectation is that such cases are dealt with by the Administrative Court under specific rules of procedure, including strict time limits.⁵⁸ If it is ‘just and convenient’ to do

⁵⁸ Generally speaking, this is three months from the claim arising. In certain cases, the claim for judicial review can be made to the Upper Tribunal (Tax and Chancery Chamber) but those categories do not include legitimate expectation cases. They are particular types of claims made where the case has gone to the FTT and there is no right of appeal.

so, the High Court may transfer the case to the Upper Tribunal. This allows the expertise of the Upper Tribunal to be used. For example, in the case of *R(oao) Capital Accommodation (London) v HMRC*,⁵⁹ the claim involved the application of the detailed VAT rules and the application of HMRC's VAT guidance regarding corrections of VAT returns. The guidance set out the basis on which a correction could be made under specific statutory powers which enable HMRC to permit corrections in such manner and within such time as they require.⁶⁰ There is no right of appeal regarding the exercise of that power by HMRC. The taxpayer's only course of action to challenge the use of that discretion was judicial review and the case was transferred to the Upper Tribunal for it to consider.

- 5.34 There may also be situations where a judicial review case is transferred from the Administrative Court to the Upper Tribunal for the Upper Tribunal to consider the judicial review application in a combined hearing with the FTT, which hears the substantive appeal. Alternatively it is possible for the substantive appeal to be transferred from the FTT to the Upper Tribunal as well, but this requires both parties' consent (and HMRC does not always agree), and places a burden on the Upper Tribunal faced with the substantive appeal evidence.
- 5.35 The High Court does not always agree to transfer a case to take advantage of the tax expertise of the Upper Tribunal. In *R(oao) Hankinson v HMRC*,⁶¹ the court refused to transfer a case involving questions regarding the taxpayer's residence and HMRC's guidance because two similar cases were being decided at the level of the Court of Appeal (the *Gaines-Cooper* and *Davies* cases also considered in this paper) and there was an appeal on the substantive issues at the FTT. HMRC were refusing to consent to the transfer of the substantive appeal from the FTT to the Upper Tribunal and the judge in the High Court considered that the statement of facts from the FTT would be needed to decide the judicial review case.
- 5.36 So a taxpayer is usually faced with bringing two cases in two courts: judicial review in the High Court and the substantive appeal in the tax tribunal. Which should come first? The problems are illustrated in the case of *Daniel v HMRC*.⁶² As in the *Gaines-Cooper* case, the taxpayer was seeking to rely on IR20. Mr Daniel had appealed against a tax assessment to the FTT. At the same time, he had made an application to the Administrative Court for judicial review that he had a legitimate expectation that HMRC would apply the provisions of IR20 to his case. Which case should be dealt with first? Mr

⁵⁹ [2013] STC 303.

⁶⁰ Regulation 35 of the Value Added Tax Regulations 1995.

⁶¹ [2009] STS 2158.

⁶² [2013] All ER (D) 189.

Daniel argued that the judicial review case should be decided first, arguing that it was a quicker case and that if he won, HMRC would need to think again about his tax assessment. However, the Upper Tribunal decided, and this was affirmed by the Court of Appeal, that in order to determine whether Mr Daniel may be able to rely on IR20, a detailed analysis of the facts was necessary and this was the job of the FTT in the context of the appeal.

- 5.37 The decision in the *Daniel* case takes the opposite approach to the courts in the *Gaines-Cooper* case, where it was decided that the judicial review application should be considered first. In the *Gaines-Cooper* case, the taxpayer argued, successfully, that the judicial review claim raised the question whether the Revenue is disentitled from contending that they remained resident in the UK, whether or not the Revenue's contention would succeed on the merits before the Special Commissioners. The court was particularly concerned that a decision on residence by the Special Commissioners might rule out a subsequent granting of judicial review because of those authorities that indicate that a legitimate expectation cannot operate where it would conflict with a statutory duty (i.e. if the taxpayer is found to have been a UK resident as a matter of law, legitimate expectation cannot override that).
- 5.38 At first, it might appear surprising that in the *Gaines-Cooper* case, the decision was made to consider the judicial review claim first. If HMRC's statements had been ultra vires, then no legitimate expectation would have arisen. However, as noted above, the court focused on the construction of IR20 and the vires of that leaflet was not the issue. While the difference in approach between the two cases can be explained, it does mean that taxpayers are left not only with two claims in two courts, but also with uncertainty in some cases as to which case should be dealt with first.
- 5.39 A potential solution to these procedural problems would be to start both the judicial review claim and the substantive appeal in the FTT. However, under the current court rules, it would not be possible to bring a judicial review claim in the FTT.⁶³ Despite this, or perhaps because of this, the FTT has considered the extent to which it can consider public law based arguments in its tax appeal jurisdiction. The extent to which that is possible has been the subject of numerous cases in the last two years and is now in a complex, uncertain and unsatisfactory state.
- 5.40 In the *Oxfam* case considered above, the judgment of Lord Justice Sales led to some concluding that there was at least some scope for a judicial review claim to be considered by the FTT. Lord Justice Sales said that the jurisdiction of the

⁶³ See Tribunals, Courts and Enforcement Act 2007, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/367601/upper-tribunal-procedure-rules.pdf and https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/357075/tax-chamber-tribunal-procedure-rules.pdf.

FTT was ‘wide enough to cover any legal question capable of being determinative of the issue’. However, a narrower approach was taken by the Upper Tribunal in *Noor v HMRC*.⁶⁴ (Mr Noor was not represented and it is therefore possible that another case will distinguish the *Noor* case and establish a different principle. This seems unlikely though, as the reasoning of the Tribunal is convincing.) The Upper Tribunal decided that the FTT does have the power to consider cases arising under the legislation, but it could not, for example, decide a case as to whether the taxpayer had a legitimate expectation that HMRC would act in a way which was outside the legislation. The judgment weaves its way through argument and counter-argument as to what the jurisdiction of the FTT should be and the result is far from straightforward.

- 5.41 On the one hand, it is stated that the FTT has no judicial review function. This was based on the fact that the Tribunals’ powers were set out in the Tribunals, Courts and Enforcement Act 2007 and that statute conferred a judicial review function only on the Upper Tribunal. In addition, it was pointed out that if the FTT did have the power to consider judicial review applications, there were none of the procedural safeguards, including, in particular, the filter of permission for judicial review and the time limits to which non-tax applications are subject. On the other hand, this does not mean that the FTT can never take into account, or give effect to, public law issues such as legitimate expectation. That could take place when it was ‘necessary to do so in the context of deciding issues clearly falling within its own jurisdiction’.⁶⁵ This means that where legislation gives HMRC discretion, the FTT can consider whether it has been exercised reasonably. In contrast, the FTT cannot consider a case based on a contract which it is said that HMRC entered into but which it did not have the power to enter into, or a claim based on legitimate expectation where HMRC are said to be acting outside their powers. In other words, the FTT cannot consider a case where the legitimate expectation would be founded on an act that was itself ultra vires. In contrast, the power to enter into a contract, or otherwise give rise to a legitimate expectation, could arise under HMRC’s general care and management powers, or under a specific statutory power.⁶⁶ In these cases the FTT could consider the public law issues.
- 5.42 This approach has subsequently been endorsed by the FTT in various cases.⁶⁷ In *LH Bishop and others v HMRC*,⁶⁸ the tension between the decisions in the *Oxfam* case and the *Noor* case were expressly recognised by Judge Mosedale. She concluded that as *Oxfam* took a wider view of the public law jurisdiction

⁶⁴ [2013] UKUT 071(TC).

⁶⁵ Ibid see paragraph 31.

⁶⁶ Ibid see paragraph 87.

⁶⁷ *Carlsberg UK v HMRC* [2013] UKFTT 573; *McAndrew Utilities Limited v HMRC* [2012] UKFTT 749; *Taygroup v HMRC* [2013] UKFTT 336.

⁶⁸ [2013] UKFTT 522 (TC).

of the FTT and *Noor* took a narrower view, and neither was more binding than the other, she could choose which approach to adopt. Judge Mosedale went on to veer towards the *Noor* approach: ‘Parliament would have intended this Tribunal to have jurisdiction over the application of tertiary legislation and ESCs and contracts and special methods entered into by HMRC, but not over more general questions of legitimate expectation and in particular this Tribunal could not hold HMRC to unlawful exercise of its statutory powers and duties.’ However, she also went on to draw a distinction between a complaint that HMRC have assessed the taxpayer in reliance on an unlawful act by HMRC, which the FTT can consider; and a complaint that although the assessment is lawful, HMRC have unlawfully failed to exempt the taxpayer from liability, which the FTT cannot consider. Her concern was that the latter was essentially a claim that HMRC had acted unfairly and that such a claim should only be made via the more restricted rules applicable to judicial review in the High Court.

- 5.43 The judgment in the *Bishop* case draws fine distinctions as to which cases may or may not fall within the FTT’s jurisdiction. However, it is also in conflict with another recent FTT case, *Prince, Bunce and Coaker v HMRC*,⁶⁹ where Judge Bishopp decided that the FTT could not consider a case about whether an ESC could be relied upon (a decision recognised by Judge Mosedale as being in conflict with her own view). Judge Bishopp said ‘There can, I think, be no room for doubt that this tribunal does not have any judicial review jurisdiction.’⁷⁰ Judge Bishopp distinguished a case such as *Oxfam* as being a case where the court was being asked to decide the amount of tax due (which could fall within the FTT’s jurisdiction); as opposed to a case considering whether HMRC should be required to exercise their discretion not to collect the tax (which could not fall within the FTT’s jurisdiction).
- 5.44 The recent case of *HMRC v Mitesh Dhanak*⁷¹ shows that there are further problems with navigating the current system of appeals and judicial review. Mr Mitesh appealed amendments to his self-assessment tax returns made by HMRC, following the refusal of a relief. HMRC argued that the refusal of that relief could not be the subject of a statutory appeal but could be challenged only by way of an application for judicial review. HMRC applied to the FTT for directions striking out Mr Mitesh’s appeal on the grounds that the FTT had no jurisdiction to consider the refusal of relief. The FTT dismissed the application by HMRC but gave permission to appeal its decision. Meanwhile, Mr Mitesh had applied for judicial review of the same HMRC decision to deny the relief. The appeal and claim for judicial review were to be heard together

⁶⁹ [2012] UKFTT 157 (TC).

⁷⁰ See paragraph 30 of the judgment.

⁷¹ [2014] UKUT 0068 (TCC).

and (after some further procedural problems concerning the jurisdiction of the particular judge) they were heard together in the Upper Tribunal. The Upper Tribunal decided that Mr Mitesh was not entitled to challenge the denial of the relief by way of an appeal but by judicial review. However, it was clear, not least from the decision made in the FTT, that this conclusion was not one which a taxpayer or their advisors would easily reach.

- 5.45 To do full justice to the nuances and distinctions that have been put forward by the courts in the last couple of years in this area would be an exercise beyond the scope of this paper. What is clear though is just how confused the current situation is. If a taxpayer proceeds by way of judicial review in the High Court and an appeal in the FTT, then it can be unclear which should come first. If a taxpayer seeks to bring a claim based on legitimate expectation, or other public law basis, in the FTT, then it is unclear whether the FTT is able to decide the matter. To take one example, the FTT has said in one case that it is capable of deciding cases based on the application of ESCs, but in another case the FTT said that it cannot consider such a case. This is not a satisfactory position and it is considered further below from paragraph 7.15.
- 5.46 Before moving on to consider the practical problems arising from the current state of the law regarding legitimate expectation, two alternative procedures for redress should be noted. The first of these is the Adjudicator. The Adjudicator considers complaints made regarding HMRC. To begin this process, the taxpayer must seek two levels of review by HMRC. If these do not resolve the issue, then the taxpayer may refer the matter to the Adjudicator. If the taxpayer still considers that the matter has not been appropriately resolved, they can ask their MP to refer the case to the Parliamentary Ombudsman. The Adjudicator is able to consider the use of discretion and poor or misleading advice, albeit that it is an appointment made by HMRC. For example, in the Adjudicator's Annual report for 2013, a tax credit case was noted. In the case concerned an individual ('Mr F') enquired about help with childcare costs and was told that he qualified. Only after arranging and paying for childcare was he then told that he did not qualify, causing him financial hardship and domestic upheaval. HMRC had sought to argue that as he had benefitted from the childcare he had not suffered any detriment and therefore could not enforce their advice. However, the Adjudicator disagreed and HMRC agreed to reimburse Mr F's childcare costs and to pay compensation for the worry and distress they had caused.⁷²
- 5.47 Details of what analysis is applied in a case like this are not available. There is no sign of consideration of whether the original statement, that the childcare benefit was available, was ultra vires. Indeed, it seems to be accepted that the

⁷² <http://www.adjudicatorsoffice.gov.uk/pdf/report2013.pdf>.

Adjudicator is permitted to act outside the constraints imposed by judicial review. Perhaps this is because it is not a judge exercising authority over the administration of government (which, as discussed above, the judiciary are loathe to do, for good constitutional reasons), but because it is another administrator exercising authority over the administration; and because the Adjudicator's decisions are not strictly binding on HMRC (and they have been rejected in the past). However, the Adjudicator will not deal with matters where there is a possible appeal route to determine the issue. Therefore, the Adjudicator's role, while a worthwhile check on HMRC, is not a solution to many of the problems considered in this paper.

- 5.48 The second possible means of redress is also limited in scope. Business and Personal Tax Contentious Issues Panels have been set up within HMRC. The Panels decide the departmental strategy for handling major contentious issues. An example of their operation was seen in the consideration by the Personal Tax Contentious Issues Panel of the *Mansworth v Jelley* legitimate expectation cases.
- 5.49 The *Mansworth v Jelley* case⁷³ involved the tax treatment of share options. Following the case, HMRC issued guidance in January 2003 regarding the calculation of the gain or loss on the disposal of shares acquired under unapproved employee share options and Enterprise Management Incentive share options exercised before 10 April 2003. For many recipients of such share options, applying the guidance gave rise to a capital loss and many amendments were hurriedly made to self-assessments prior to them being out of time on 31 January 2003. HMRC published revised guidance and suggested that taxpayers needed to amend their self-assessment to reflect the amended guidance, but many taxpayers had already utilised the losses.
- 5.50 Legitimate expectation discussions ensued. If a taxpayer had calculated their tax based on HMRC guidance and could prove they had relied on that guidance, was there a legitimate expectation that the guidance available at that time could be relied upon? After protracted negotiations, including negotiations between the Chartered Institute of Taxation (CIOT) and HMRC, the matter was referred by HMRC to the Contentious Issues Panel. The Panel ruled in 2013 (although the ruling was only published a year later) that losses would be available to taxpayers to the extent that they could show that, on the balance of probabilities, they had relied on the 2003 guidance to their detriment and legitimate expectation could have been demonstrated at the time, but no longer could be because of delay.
- 5.51 The scope of this means of redress is therefore very limited. There is no means for a taxpayer to refer the matter to the Panel; it will only consider matters that

⁷³ [2003] STC 53.

HMRC perceives to have substantial or far-reaching impact; and it is a slow process.

6 Practical Problems with the Use of HMRC's Discretion

- 6.1 There is a wide spectrum of material generated by HMRC and relied upon by taxpayers, ranging from specific individual clearances made under full disclosure of all relevant facts, through Statements of Practice and HMRC booklets to HMRC Manuals. The courts have been most ready to enforce the specific clearances, but as the cases move through the spectrum, so reliance upon the statements becomes more difficult. Weighing against the ability of taxpayers to rely on statements runs the very real concern as to whether HMRC's advice/position/guidance is ultra vires.
- 6.2 HMRC's Admin Law Manual describes how HMRC considers the law to apply to guidance and advice given in it.⁷⁴ In particular, at paragraph ADML1605, it is stated that 'only in exceptional circumstances will HMRC be bound by incorrect advice'. Such a statement does not sit easily with the aim of providing taxpayers advice at key lifetime events. The unrepresented, non-expert taxpayer will not have considered for one moment that the advice given to them is potentially so unreliable.
- 6.3 However, pressure from government has been increasing for HMRC to go beyond what would previously have been seen as its collection and administration rule. One example of this is seen where HMRC is required to set out guidance as to how legislation is expected to operate, where the legislation is clearly, on its face, insufficiently clear for taxpayers to be able to use and rely upon it. A recent example is the guidance provided to supplement the introduction of the statutory residence test, which explains concepts such as 'home'. Is this really dealing with what Lord Hoffmann described as the interstices of the legislation or is it plugging gaping holes? If the latter, then is that within HMRC's powers?
- 6.4 Similarly the tax arbitrage legislation uses several concepts, such as 'minimal', which are not defined but which are interpreted by HMRC guidance.⁷⁵ On what basis has HMRC reached a decision that £50,000 is the cut off for 'minimal' and for how long will it remain at that amount? Is it really the role of HMRC to reach such a conclusion?

⁷⁴ See ADML 1200 onwards: <http://www.hmrc.gov.uk/manuals/admlmanual/adml1200.htm>. Interestingly, a less strident tone is adopted in the webpages addressed to readers of the Manuals, rather than HMRC officials, introducing the Manuals and setting out how they can be used: <http://www.hmrc.gov.uk/manuals/advisory.htm> and <http://www.hmrc.gov.uk/pdfs/info-hmrc.htm>.

⁷⁵ Sections 24–27 Finance (No2) Act 2005 and <http://www.hmrc.gov.uk/manuals/intmanual/intm595080.htm>.

- 6.5 Of even greater difficulty is the situation where the guidance reaches a different conclusion from that reached by the legislation. The example most often cited for this problem is Section 16A of the Taxation of Chargeable Gains Act (TCGA) 1992 (which restricts the use of allowable losses against chargeable gains) and the guidance notes that accompanied it. A fuller analysis of the problems with that provision is set out elsewhere⁷⁶ but in essence the problem is that the legislation clearly leads to the disallowance of losses where the guidance says that those losses would be available. It is difficult to see how HMRC's statements in the Section 16A guidance fall within the description of the scope of HMRC's collection and management discretion by Lord Hoffmann in the *Wilkinson* case. Similar problems arise again with the arbitrage legislation.⁷⁷ What should a taxpayer do when HMRC guidance differs from the conclusion reached just by reading the legislation? HMRC does not have the power to legislate and HMRC's interpretation is not binding on the courts, yet on a strict reading of Section 16A TCGA, for example, many transactions are potentially subject to tax, and the basis on which they are not in fact taxed is the statements made by HMRC in accompanying guidance. This conclusion does not sit comfortably with the obligation of taxpayers to get their tax position right under self-assessment⁷⁸ and leaves taxpayers exposed to changes in that guidance.
- 6.6 Such problems with non-legislative rule-making raise important implications for the consideration of the use of different drafting techniques aimed at making tax legislation clearer. One solution suggested as an alternative drafting technique is to keep the legislation as brief as possible by setting out core principles. Assuming that it is possible to do so, this will leave much of the detail as to how the rules are to work unstated by the legislation. Taxpayers, though, will want clarity about the precise operation of the rules and therefore will demand guidance. Who should provide the guidance? If HMRC provides it, are they going beyond their collection and management powers and if not, will that guidance fall within the parameters of the *Cameron* case?⁷⁹
- 6.7 This is an issue that was identified as a cause for concern in the Aaronson report on what has now (after modification) been enacted as the GAAR. Graham Aaronson Q.C. suggested that HMRC should not draft the guidance

⁷⁶ See TLRC Discussion Paper No 7 at paragraph 7 (<http://www.ifs.org.uk/comms/dp7.pdf>) and Judith Freedman and John Vella, HMRC's Management of the UK Tax System: The Boundaries of Legitimate Discretion, in Chris Evans, Judith Freedman and Rick Krever (eds), *The Delicate Balance – Tax, Discretion and the Rule of Law*, IBFD, 2011; Oxford Legal Studies Research Paper No. 73/2012 (<http://dx.doi.org/10.2139/ssrn.2174946>).

⁷⁷ Other examples include Section 30 Finance Act 2014, which requires arguably concessionary practice to narrow its scope to the intended targets, and in the context of employee taxation of employer-owned accommodation benefits, the situation where the legislation provides for one value but the guidance uses another; see OTS Final Report on the Taxation of Employee Benefits and Expenses at paragraph 1.63: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/339496/OTS_review_of_employee_benefits_and_expenses_final_report.pdf.

⁷⁸ See paragraph 5.16 above.

⁷⁹ See paragraphs 5.29 and 5.30 above.

that would sit alongside the GAAR. In addition, partly because of the concerns about the ability to rely on changing guidance, Aaronson also recommended that the guidance is given statutory authority by being set out in primary or secondary legislation. However, in the actual GAAR as enacted, the solution to these problems is to have two tiers of HMRC guidance: one which is approved by the Advisory Panel for the GAAR and which ‘must’ be taken into account by the courts in considering the application of the GAAR; and the other which is any other guidance, statement or other material that is in the public domain and which ‘may’ be taken into account by the courts.⁸⁰ In so doing, the provisions throw into focus the debate about the extent to which HMRC’s guidance, statements and even clearances may be relied upon and open up the possibility of having tiers of guidance that have different levels of reliability and enforceability.

- 6.8 If a taxpayer asserts that the guidance means that the GAAR should not be applied, the taxpayer does not need to seek judicial review of HMRC’s decision to apply the GAAR but can appeal the application of the GAAR and its guidance. This is also potentially the case as regards the guidance or other materials which the courts may take into account for the purpose of the GAAR. The courts have been effectively authorised to consider the application of not just the statute but the guidance as well.

- 6.9 Turning to the position of general guidance such as Manual guidance, the *Hanover* case showed that the courts are reluctant to treat the Manuals as giving rise to legitimate expectations. This is a difficult and hugely important area for taxpayers. For example, businesses are supposed to be able to work out their tax obligations as employers via the HMRC web site. If an employer looks at the National Insurance guide, CWG5, to check which class of National Insurance applies to employee remuneration, the employer will find a long list purporting to set out the differing treatments of various payments and benefits. However, at the top of that list is a warning: ‘The chart is not comprehensive and has no legal force. It gives guidance only.’ In practice, employers, and especially small or new employers, would be expected to look to the published HMRC list and to assume that the list can be relied upon. Similarly, taxpayers will often be signposted by the HMRC Toolkits to areas in the Revenue Manuals for guidance and will never see the caveat regarding the status of the opinions stated there. As a practical matter, web site guidance is constantly changing, and what a taxpayer may have relied upon may no longer be there when the taxpayer is seeking to rely on that guidance.

- 6.10 The Manuals are prepared on the basis of being internal guidance for HMRC employees. They are available to the public, although they could be said to be

⁸⁰ Section 211 Finance Act 2013.

no more than HMRC's statement of how it interprets the law. On the one hand, while it would be reasonable to expect HMRC to apply its interpretations consistently between taxpayers (and the Manuals may be evidence of how HMRC applies its interpretations), it would be unacceptable for the Manuals effectively to become authoritative statements of what the law is. That role is not for HMRC but for the courts. Advisors should not be able to simply argue that they looked at a Manual and told their client what the Manual said. Advisors should be considering for themselves what the law says and consult the Manuals for guidance as to HMRC's interpretation. Where there is an actual or potential divergence, taxpayers should be warned by their advisors. On the other hand, it is recognised that this treatment of HMRC's Manuals and guidance does not necessarily sit easily with political pressures for there to be more non-legislative rule-making by guidance. It also does not sit well with HMRC's own approach to the use of guidance: explicitly referring taxpayers to areas within them for clarification of the taxpayers' obligations; and refusing to give businesses non-statutory clearances where HMRC considers that the position is dealt with by the Manuals and is therefore insufficiently uncertain.

- 6.11 What about the implications of relying or not relying on the Manuals through an advisor? An unrepresented taxpayer can reasonably be expected to take the Manuals at face value. Should the system distinguish between the represented and unrepresented taxpayer when applying the doctrine of legitimate expectation? Bearing in mind the detailed weighing up of all the factors, it is not wholly surprising if there is a difference. It is perhaps not so much that a taxpayer cannot rely on the Manuals through an advisor but that the presence of the advisor makes it less reasonable to take the Manuals at face value.
- 6.12 Government pressure for HMRC to improve its interaction with taxpayers and at the same time to cut costs is also seen. HMRC has set out various goals in its Business Plan 2012–2015.⁸¹ One of these goals is to ensure that for major events in taxpayers' lives, such as retirement or changing jobs, there are both good guidance and simple-to-use processes. If these are to be of use to the taxpayers at whom they are aimed, it is vital that they can be relied upon by those taxpayers. It will often be unreasonable to expect that such individuals will have access to independent tax advice. Under the current law, taxpayers could not easily rely on just telephone advice. Although the telephone advice may be within the ostensible authority of the officials giving it, the *Corkteck* and *Watson* cases made clear that it is difficult for taxpayers to have an enforceable legitimate expectation as a result of a phone call. The courts have told HMRC that it should warn taxpayers that any assurance should be confirmed in writing as a practical matter, but this is fraught with problems.

⁸¹ <http://www.hmrc.gov.uk/about/business-plan-2012.pdf>.

First, the taxpayer may be unable to record the matters reliably in writing. Second, HMRC would have difficulty in dealing with such correspondence within its resource constraints.

7 How Could the System be Improved?

- 7.1 HMRC's use of its discretionary powers is something which both taxpayers and government press for at various times. It is in taxpayers' interests that there is flexibility in the application of the system and taxpayers will often call for guidance and clarification as to how HMRC will apply the law. Governments seem prepared to grant HMRC wide discretion for varying reasons, whether that is an attempt to 'simplify' the tax legislation (and put the detail in HMRC guidance) or the granting of new discretionary powers such as those introduced for the Bank Code.⁸²
- 7.2 However, the increasing use of discretionary powers by HMRC is throwing up significant practical problems for the efficient operation of the UK tax system as described above. There is a recognised pressure both from government and from taxpayers and their advisors to explain how HMRC will operate the rules and to make the system work. At the same time, taxpayers need to feel that there are appropriate safeguards on the operation of those discretionary powers. It is unreasonable to expect a taxpayer who has relied upon a statement to accept that, because the statement was ultra vires, they have no remedy where they have relied upon it. Yet it is also argued that the ultra vires rule exists to stop officials exceeding their powers. Some maintain that the making of ultra vires statements is usually inadvertent, so that the rule is unlikely to have much practical deterrence effect.⁸³ This may be so in the context of individual HMRC clearances or statements, but in the context of HMRC Manuals and other guidance, the stronger impression is that statements are made which HMRC are (or should be) aware could be ultra vires or at least at the margins.
- 7.3 Other arguments maintain that the interest of the public in a consistent system, kept within the parameters set by Parliament, outweighs the interest of the one taxpayer or group of taxpayers affected by not being able to rely on a statement or practice.
- 7.4 Similarly, it is missing the point to argue that the taxpayer does not suffer if a statement, whilst intra vires, is changed as a result of a change in the understanding of the law, because the treatment that they thought applied was

⁸² Indeed, some opinion is suggesting that this is all part of a dramatic development of the roles of the executive and administration and that policy-making power has diffused out of central government to various regulators. See Eoin Carolan, *The New Separation of Powers: A Theory for the Modern State*, Oxford University Press, Oxford, 2009.

⁸³ See Paul Craig, *Administrative Law*, Sweet & Maxwell, Andover, 2012.

wrong.⁸⁴ It could be said that the taxpayers are in the same economic position as they would be if the law was changed by a Finance Bill. However, allowing HMRC to walk away from the consequences of statements undermines confidence in the system and in the relationship between HMRC and taxpayers.

- 7.5 Does all this mean that the solution is an all or nothing one (i.e. that no remedy is available)? There is no easy solution to these problems but this paper proposes some ideas for consideration and debate.
- 7.6 First, consideration could be given to the use of HMRC guidance supplementing legislation, which is the main form of statement causing concerns regarding the application of the ultra vires rule. It is generally agreed that legislation (both primary and secondary), as interpreted by the courts, should be the primary source for tax law. This implies that the drafting should not be so inadequate that it requires HMRC to fill in the gaps. Neither should it be so cast so wide that HMRC needs to narrow its scope. In each case, such guidance may be ultra vires. The fact that there is this risk (with the consequent implications for taxpayers) is sufficient to undermine confidence more generally in HMRC statements and guidance. If these conclusions are agreed, then guidance designed for use by taxpayers and their advisors should focus on explaining how, in practice, the legislation works.
- 7.7 Does this focus on legislative drafting mean that tax legislation must be very detailed and prescriptive? Not necessarily. However, if detail is required it would be preferable to have that set out in legislation than in guidance. For example, when the recent changes to taxation of partnerships were issued as draft legislation, there was reference to a ‘substantially wholly’ test, which the legislation did not define but which HMRC guidance was stating was 80%.⁸⁵ In the legislation enacted in the Finance Act 2014, the legislation included the 80% test.⁸⁶ (Putting the detail in guidance may make the legislation seem simpler but this is not simplification of the tax system if the detail needs to be provided elsewhere.)
- 7.8 It may mean that the legislative drafting varies according to the concepts involved, whether the provision is a charging provision or a relief, and which taxpayers are affected. For example, more complex and prescriptive legislation may be more appropriate for complex corporate issues. The TLRC would be interested to hear views on this in order to develop ideas in this area further.

⁸⁴ This was one of the main arguments put forward by HMRC in discussion with the CIOT about a change in practice regarding the use of certain losses; see http://www.tax.org.uk/tax-policy/Topics/CGT/MvJ/MvJ_minutes.

⁸⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264620/4._Partnerships.pdf.

⁸⁶ Paragraph 1 Schedule 17 Finance Act 2014.

- 7.9 However, there will still be occasions when HMRC statements may be found to be ultra vires. Taxpayers who are aware of the issue are left in the unacceptable position of choosing between relying upon HMRC's guidance, which could be withdrawn or changed at any time, and applying their own analysis of the legislation, which may then be contested by HMRC. Taxpayers who are unaware of the issue will not even have that choice. They can be expected to follow the guidance, unaware of the risk that in so doing they may be found to have accounted for tax incorrectly.
- 7.10 This paper therefore agrees with those who call for review of the ultra vires rule and its impact on legitimate expectation. Options could include the following.
- 7.10.1 Introducing the ability of the courts to award compensation to the person who had relied on the statement. In tax cases, this may involve complex questions of what the compensation should be for: should it put the taxpayer in the same position that they would have been in if they had not acted upon the statement? However, if it simply compensated for the tax cost borne as a result of the change of view, this would be equivalent to allowing the original statement to be relied upon. In addition, as others have pointed out, this compensation has to come from somewhere and therefore the public interest may be affected just as much as allowing the taxpayer to rely on the original statement.
- 7.10.2 Permitting the courts to weigh up the interest of the individual in relying on the statement against the public interest of not permitting public authorities to exceed their powers. In appropriate cases, the legitimate expectation of the individual could then be enforced. This could produce some variety in outcome as a result of the different facts in different cases, but this is the situation in many instances where parties take a case to court, and especially in the context of legitimate expectation cases where there is already a detailed balancing act to carry out. The *GSTS Pathology* case considered above suggests that such an approach is not impractical. There, it was decided that even if the VAT clearance was wrong in law, the taxpayer should be given three months to correct its systems.
- 7.10.3 Giving taxpayers a clear statutory right to rely on guidance or specific forms of guidance. For example, this could be by way of extension of the approach used for the GAAR where there is guidance specifically contemplated by the legislation and which Parliament has delegated to HMRC (in that case subject to the approval of the GAAR Panel) to produce.

- 7.11 Even where the statement is not ultra vires, taxpayers are left with a limited and, at times, unclear ability to invoke the legitimate expectation doctrine in order to rely on HMRC statements. A clear set of principles, setting out what forms of HMRC guidance or clearance can be relied upon and in what circumstances, could be considered. If, for example, telephone guidance is not something which a taxpayer can rely upon, then this should be made clear and HMRC needs to warn callers appropriately. The impact on the HMRC Business Strategy would need to be addressed though: call centres are of limited use if their advice cannot be relied upon.
- 7.12 Recognising the practical problems with telephone guidance (not least the evidential problems), more extensive use of digital tools could be considered. HMRC currently offer an Employment Status Tool.⁸⁷ The tool is used to determine whether a worker is an employee or self-employed. The engager of the worker can complete the questions on the internet pages and, provided that the information given accurately reflects the terms of the worker's contract and the result is printed out, the engager can rely upon the conclusion of the tool. Such an approach could be extended to other situations. In addition, it is queried whether there would be some scope to provide call centre advice as on-line advice, perhaps even in real time?
- 7.13 As stated, it would be helpful to work out an agreed basis on which various forms of HMRC guidance could be used and relied upon. For example, it could be agreed that if HMRC wish to keep the concept of the Manuals as internal HMRC guidance, which can freely be changed, HMRC should not refer taxpayers to the Manuals for advice without making this limitation on the reliability of the advice clear. Items of guidance to which HMRC refer taxpayers would then be recognised as being items on which taxpayers can rely. If this approach was adopted, then a clearer distinction could be developed between 'publications' that taxpayers can rely on and more general guidance, such as Manuals, which they cannot generally rely upon.
- 7.14 A separate question is how to deal with changes in guidance? It is recognised that guidance may need to change from time to time as the interpretation of the law changes, whether as a result of cases or otherwise. When that happens, how should taxpayers be made aware of the change? Guidance could be clearly dated so that readers can judge how recently it has been updated. When updated, the old guidance would remain accessible but clearly flagged as superseded. When there is guidance affecting a particular group of taxpayers, how should those taxpayers be informed of the change? It would not be practical to require HMRC to contact individual members of a group. However, a more general updating publication, which flags such changes, may

⁸⁷ <http://www.hmrc.gov.uk/calcs/esi.htm>.

be a way forward, perhaps by building on and improving the Revenue and Customs Briefs currently published.

- 7.15 Aside from the substantive questions, there are, as described, significant procedural problems for taxpayers pursuing judicial review claims. One possibility which could alleviate the problems would be for taxpayers to be able to apply for a judicial review type remedy of HMRC's use of its discretionary powers in the FTT. This is not without precedent. In 2008, the Charity Tribunal was given judicial review type powers for certain specific cases, albeit that these powers have since been abolished. The cases that could be considered by the Charity Tribunal as judicial review cases were concerned with decisions made by the Charity Commission (e.g. to institute an inquiry into a particular charity). It was expressly provided that 'in determining such an application the Tribunal shall apply the principles which would be applied by the High Court on an application for judicial review'.⁸⁸ The powers of the Tribunal ranged from upholding, quashing, varying or substituting decisions, directions or orders to remitting certain matters to the Commission.
- 7.16 It is noted that the government recently has been consulting on reducing the availability of judicial review in certain cases and streamlining the process in other cases.⁸⁹ One change being made is to transfer the judicial review function in immigration and asylum cases from the Administrative Chamber of the High Court to the Upper Tribunal. A similar proposal involves moving planning judicial review cases to a new planning chamber of the Upper Tribunal. There is an argument that the same should happen for tax, allowing cases to start at the level of the Upper Tribunal.
- 7.17 Alternatively, the FTT could be given clear powers to consider legitimate expectation cases based on a taxpayer contract setting out the principles for the use of HMRC's discretionary powers. This could be as part of the Taxpayers' Charter. Another possibility would be to provide an explicit set of rules as to what can and cannot be relied upon in statutory form, following the example of the GAAR legislation. Enabling the FTT to consider taxpayers' claims to rely on HMRC statements would not only provide a simpler and more cost-effective remedy generally for taxpayers, but it would also deal with the problem faced in the *Daniel* and *Gaines-Cooper* cases of deciding whether the judicial review application or the appeal should be heard first. This right to rely on guidance may need to consider the reasonableness of a taxpayer relying on the advice. For example, if the taxpayer is represented or has the technical expertise to realise that the guidance is clearly out of date, it may not be reasonable for the taxpayer to 'take advantage' of outdated guidance.

⁸⁸ Paragraph 4(4) Schedule 1C Charities Act 1993.

⁸⁹ See <https://consult.justice.gov.uk/digital-communications/judicial-review>.

- 7.18 Regardless of whether the Upper Tribunal or FTT were chosen, clarity over this issue and a clear route into one or the other would be a major step forward. However, if the Upper Tribunal became the court to which judicial review applications were made, there would still need to be a clear set of procedures to deal with cases where a substantive appeal is made at the same time (especially as to which aspect of the matter is dealt with first).
- 7.19 Even with changes of this kind, there would still be many cases where the taxpayer cannot afford to pursue a claim through the courts, or is not informed enough to understand the time limits applying to judicial review. The Adjudicator notes in her report that ‘during 2012–13 we received 1331 new complaints about a range of taxation issues. This was an increase of 107% on 2011–12 and accounted for 52% of the total number of complaints received.’⁹⁰ The Adjudicator welcomes the efforts HMRC has made subsequently to address this problem but it is suggested that more still needs to be done. This paper suggests that an open discussion regarding the complaints procedure, and how it could sensibly be used to deal with taxpayer’s legitimate expectations, would be welcome. This discussion could address the extent to which different forms of statement and publication can be relied upon.

8 Conclusion

- 8.1 The ability of taxpayers to rely on, and hold HMRC to, guidance, statements and even clearances is closely limited by the principles of judicial review and, in particular, the limits of the doctrine of legitimate expectation. Increasingly, a tension is seen between the limited safeguards offered to taxpayers by the legitimate expectation doctrine and the pressure for HMRC to use its discretionary powers. The time has come to consider ways to ease that tension in order to facilitate the operation of the tax system.

⁹⁰ See <http://www.adjudicatorsoffice.gov.uk/pdf/report2013.pdf> at page 12.