Manual transmission

Management of taxes



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Keith Gordon considers a recent judicial review claim concerning the extent to which taxpayers can rely on the contents of HMRC’s manuals

Key Points

What is the issue?

How much is a taxpayer entitled to rely upon the manuals?

What does it mean to me?

The case is further confirmation that a legitimate expectation claim is likely to fail if the taxpayer cannot show that they acted to its detriment by relying on the representation made by it.

What can I take away?

One particularly helpful aspect of the judgment is that gives readers clear pointers that should allow similar claims to be more successful.

It is now more then 20 years since the first publication of HMRC's manuals. Although the manuals are written to guide HMRC officers as to the official line to take in respect of the statutory code, their availability to the public means that taxpayers and advisers can gain an insight as to the likely HMRC reaction to any particular transaction or arrangement. The public version of the manuals contains a health warning which warns readers that the guidance will not necessarily be followed in cases involving avoidance. In addition, there is always the risk that the guidance might be out of date (because of new interpretations or legislation etc). Those warnings, however, lead to the question as to how much is a taxpayer entitled to rely upon the manuals in other cases. That was the subject of a recent judicial review case (*R (on the application of) Aozora GMAC Investment Ltd v HMRC* [2017] EWHC 2881 (Admin)).

Facts of the case

The full facts of the case are unlikely to interest readers who do not deal regularly with the interaction of the double tax relief provisions and treaty relief. I shall therefore try to distil them to capture the essence of the case and would suggest that any reader who wants greater detail reads the judgment itself (and for readers wishing to read about the evolution of the 2001 treaty with the USA to consider paragraphs [18] to [30] in particular). For present purposes, I will simply mention that double tax relief can usually take one of two forms: treaty relief (i.e. relief given under the terms set out in a treaty agreed between the UK and an overseas jurisdiction) or unilateral relief (where, as it sounds, the UK provides tax relief in the absence of equivalent treaty relief).

Cut to its basics, Aozora Japan (a Japanese parent company) established a wholly-owned UK subsidiary (Aozora GMAC Investment Ltd, ('Aozora UK')) which in turn established a wholly-owned US subsidiary. The role of Aozora UK was to access finance for the wider group and for the US subsidiary in particular. The arrangement was also thought to be tax-effective. In particular, the Aozora group, which had taken professional advice throughout the process, was aware of a particular hazard in the form of section 793A(3) of the Income and Corporation Taxes Act 1988.

Section 793A had been inserted into the code by the Finance Act 2000 so as to limit the availability of double tax relief in certain situations. Section 793A(3) precluded unilateral relief in cases where any specific treaty with another jurisdiction expressly precluded relief under the treaty.

The Aozora group's professional advice considered that section 793A(3) was targeted at what became article 24(4)(c) of the UK/US treaty and it was rightly considered that that article did not apply to the group's arrangements. Furthermore, and this is the critical part for the present case, at the time, HMRC's international tax manual also made the express statement that the sole provision which could trigger section 793A(3) was indeed article 24(4)(c) of the UK/US treaty.

Subsequently, however, HMRC changed their mind and considered that section 793A(3) could also apply in UK/US cases where treaty relief is affected by article 23 of the treaty. The group's advisers had considered that they might be able to avoid being caught by article 23 and obtain treaty relief; however, even if they were unsuccessful in that endeavour, they were comforted by the thought that unilateral relief was available given the (perceived) non-application of section 793A(3) to article 23 cases. As already noted, at the time that view was in accordance with that held within HMRC.

In due course, however, a revised HMRC view led to HMRC denying unilateral relief, a decision which was confirmed upon internal review. As a consequence, Aozora UK has lodged an appeal in the Tribunal to consider whether or not HMRC's revised view is correct. In the meantime, it also commenced judicial review proceedings on the basis that the change of view represented a breach of the company's legitimate expectation and therefore it was conspicuously unfair for HMRC to resile from their published view.

The High Court's decision

The case came before Sir Kenneth Parker.

He dismissed the company's claim. The consequence is that the correct interpretation of the subsection will proceed to be considered by the First-tier Tribunal on appeal in the ordinary way.

Commentary

Although the outcome of the case was undoubtedly a disappointment for the Aozora group, there are a number of aspects of the Judge's decision which should provide comfort to taxpayers more widely.

Most notably, despite HMRC's arguments to the contrary, the Judge accepted that statements In HMRC's manuals can amount to a 'relevant representation' for the purposes of the legitimate expectation doctrine. And, in particular, the statement at the heart of Aozora UK's case was capable of being such a representation. Using the test set out in earlier case law, the statement was sufficiently 'clear, unambiguous and devoid of relevant qualification'. Furthermore, although the manuals are prefaced with a disclaimer, the preface also advises readers that 'subject to [those] qualifications … readers may assume that the guidance will be applied in the normal case'.

The Judge also accepted that the statement satisfied the test, even when read in context. As the Judge put it, even after any thorough examination of HMRC's manuals, the statement in the manual was 'clear and unequivocal'. Since the guidance referred only to article 24(4)(c) of the treaty, the hypothetical reader (an 'ordinarily sophisticated taxpayer') was not required to look beyond that article to identify other potential provisions in the treaty that might invoke section 793A(3).

In addition, the Judge considered an alternative proposition – being that the test should be applied not to a mere ordinarily sophisticated taxpayer, but to one suffering acute anxiety. Such an anxious taxpayer might well have looked at documents prepared during the consultation exercise prior to the enactment of the Finance Act 2000, specialist articles and contemporaneous text book commentaries. But the Judge was unable to find anything in such material that would have alerted the reader to the possible relevance of article 23. Interestingly, however, that anxious taxpayer was still not expected to consider other provisions in the treaty itself.

Also of comfort was the eminently sensible approach of the Judge to recognise that, although Aozora UK did not exist at the time when the relevant representation was said to have been made, it was possible to treat its parent as the company's proxy. Similarly sensible was the implicit acceptance that a taxpayer need not undertake the research itself but can rely on competent advisers, which Aozora undoubtedly did.

Thus the general principles which are essential to a successful legitimate expectation claim were satisfied in the present case. However, that was not enough as the Judge considered that, in the event, the company did not actually rely on the representation in the manual (or there was no evidence to suggest it had).

In particular, the advice received by the group made no reference to the manual and therefore the Judge could not conclude that the *group* had relied upon its contents. Indeed, the adviser's own evidence before the court did not suggest that he had mentioned the manual when giving his advice. On this basis, the Judge concluded that the group had relied on expert advice, rather than HMRC's manual.

What to do next

One particularly helpful aspect of the judgment is that it gives readers clear pointers that should allow similar claims to be more successful (assuming that the representation is sufficiently clear etc).

First, if the taxpayer is relying on professional advice, that professional advice should include an express reference to the representation being made by HMRC. Secondly, the adviser should also make it clear that s/he is actually relying upon HMRC's representation.

Thirdly, that advice should not merely support or encourage the adviser's own view. In practice, this could be quite limiting as an adviser should ordinarily be expected to be sufficiently competent to form an independent view. On the other hand, tax is full of so many grey areas and it is perhaps appropriate that the legitimate expectation doctrine should be restricted to such cases.

Finally, the case law is a further confirmation that a legitimate expectation claim is likely to fail if the taxpayer cannot show that it acted to its detriment by relying on the representation made to it (even if detrimental reliance is not an essential ingredient to a legitimate expectation claim). On the facts of the case, the Aozora

group (in its representations to the US tax authorities in its initial attempt to get around article 23) had asserted that the UK company had been established for bona fide commercial reasons (being closer to the group’s customers and the increased likelihood of UK-sourced finance being given to a UK company). In the circumstances, therefore, even if the group had relied upon HMRC’s manual, it would have been unable to show that setting up the UK subsidiary amounted to detrimental reliance.