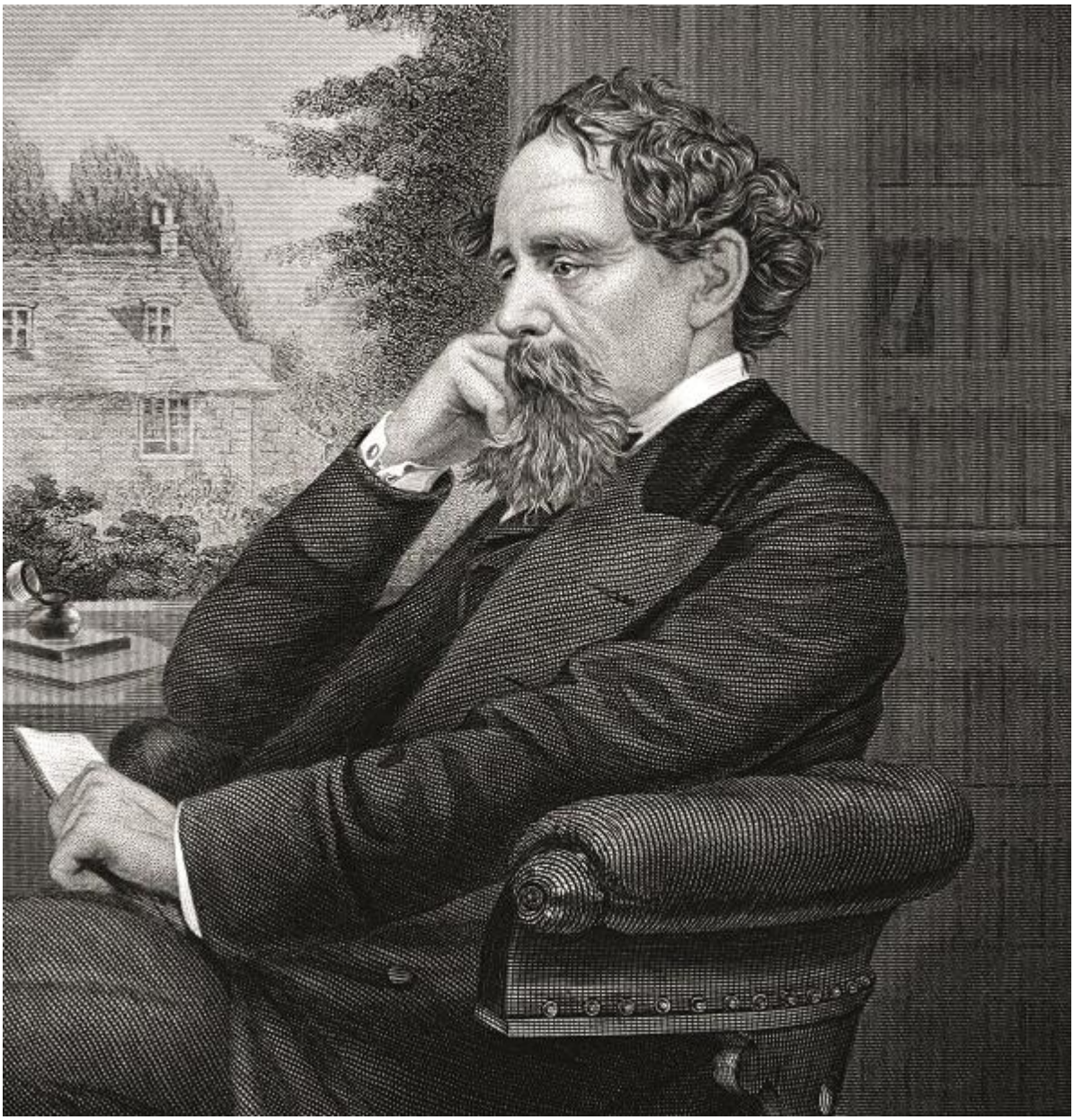
Great expectations

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Cassim Atcha and Prathab Jagajeevanram consider the judicial review decision in the cases of Samarkand and Proteus

Key Points

What is the issue?

What is judicial review and when is it appropriate? How does one apply the doctrine of legitimate expectation in tax law? Can taxpayers rely on HMRC's Business Income Manual?

What does it mean for me?

The doctrine of legitimate expectation may assist taxpayers in sustaining claims for tax relief even when the courts decide that the tax relief in question is not strictly due in law

What can I take away?

Subject to HMRC's interpretation and despite the decision going against the relevant taxpayers, it may assist taxpayers in negotiating favourable settlements on outstanding film sale and leaseback enquiries

The acquisition of an asset and its subsequent lease back to the vendor is known as a sale and leaseback (S&L) transaction. A film S&L transaction – where the asset acquired is a film – will typically display these traits:

- the acquisition of the film and its lease, in exchange for periodic rental payments, are undertaken simultaneously – there is no acquisition without agreed lease terms and vice versa;
- the lessee provides security for the periodic rental payments (which are generally fixed); and
- the net present value of the periodic rental payments is lower than the purchase price of the film.

The Upper Tribunal (UT) dismissed the appeals by Samarkand Film Partnership No.3 and Proteus Film Partnership No.1 (together the Partnerships), which undertook film S&L transactions, against an earlier decision that they were not carrying on a trade and, even if they were, not doing so on a commercial basis. This decision was discussed in our article 'Substantive appeal' in the July 2015 issue of *Tax Adviser*.

The UT upheld the FTT's decision because the acquisition and subsequent lease of a film was a composite transaction, the commercial reality of which was the acquisition of a fixed income stream rather than a speculative trading transaction. Such a composite transaction could not be said to be on a commercial basis if the net present value, calculated using the interest rate inherent in the transaction, did not produce a positive result. The consequence of the UT's decision (which is subject to further appeals by the Partnerships) is that the statutory film reliefs accessed at partnership level, and interest relief claims made by the partners personally on loans taken out to subscribe to the Partnerships, are denied in full.

If the decision is not overturned on any further appeal, typical S&L transactions, particularly film S&L transactions undertaken by partnerships where tax reliefs were made available by parliament, could be viewed strictly in law as uncommercial non-trading transactions and will not attract those reliefs.

This brings us to a consideration of the statements made by HMRC in their B*usiness Income Manual (BIM)* and the practice of giving relief to sale and leasebacks before the Partnerships' appeals.

The Partnerships had, along with their substantive appeal, applied for the judicial review of HMRC's decision to deny them statutory film relief. The primary ground for challenge was their legitimate expectation that relief would be given, founded on the BIM.

What is judicial review?

A claim for judicial review is defined in the Civil Procedure Rules (CPR) Pt 54 as 'a claim to review the lawfulness of (i) an enactment; or (ii) a decision, action or failure to act in relation to the exercise of a public function'. In essence, the lawful and fair exercise of public law functions is supervised by the courts by way of judicial review proceedings.

Leave for permission to apply for a review must first be sought from the administrative court. It is unlikely to be granted if the applicant has not exhausted other avenues of challenge. Judicial review should therefore be seen as a last resort. A prime example is the challenge to accelerated payment notices, where taxpayers have no statutory right of appeal – albeit, they can make written representations to HMRC – and many are hence seeking remedy through judicial review.

Legitimate expectation

The doctrine of legitimate expectation is well established as a distinct ground for judicial review in tax law. A legitimate expectation arises when the claimant expects to be treated in a particular manner by a body exercising a public function as a result of their words or conduct. Such an expectation is protected by law and it would be an unjust exercise of power for that body to frustrate the claimant's expectation.

Applying this doctrine to the words and conduct of HMRC, it is understood that, if HMRC issue a ruling on the application of the law to a taxpayer's personal circumstances, that taxpayer acquires a legitimate expectation to be treated in accordance with that ruling, as long as it is 'clear, unambiguous and devoid of relevant qualification' (*R v Inland Revenue Commissioners, ex parte MFK Underwriting Agencies Ltd and related applications* [1989] STC 873).

The Supreme Court, in considering statements from IR20 (a booklet on residence which has now been superseded by HMRC6), ruled that a legitimate expectation could also arise from statements published by HMRC (R (Davies) v R & C Commrs [2011] UKSC 47).

The Partnerships in this case relied on statements in HMRC's *BIM*. Crucially, the doctrine of legitimate expectation was accepted by HMRC in *Samarkand* as being equally applicable to the *BIM*. HMRC's case was instead built around the *BIM* being 'read as a whole'.

Business Income Manual

The guidance in the *BIM* relating to film and audio products is found at BIM 56000 et seq.

The *BIM* states that the purpose of statutory film reliefs was to encourage investment in qualifying British films to build a profitable and self-sustaining industry. It is acknowledged that the reliefs are rarely accessed directly by film producers themselves, but are usually claimed by financial intermediaries – for example, banks or partnerships of wealthy individuals – who have taxable income to shelter.

The *BIM* notes that the most common arrangements are S&L partnerships, *BIM* 56455 provides a 'simplified' worked example of a 'plain vanilla' S&L transaction, which includes the lessee placing enough funds on deposit to guarantee the periodic rental payments, with the net present value of those being inherently less than the purchase price of the film. The *BIM* states that 'the experience of anti-avoidance group is that schemes that depart radically from the structure described, and in particular are more complex, are likely to carry a high risk of tax avoidance'. The *BIM* also contains the following 'health warning': '…readers may assume that the guidance given will be applied in the normal case; but where HMRC consider that there is, or may have been, avoidance of tax the guidance will not necessarily apply.'

The Partnerships argued that they had a legitimate expectation that HMRC would not fail to grant relief on the basis that the Partnerships were not trading or trading commercially, based on structural features that are implicitly present in the plain vanilla example in the *BIM*, such as an uncommercial return or risk-free guaranteed returns. HMRC, on the other hand, contended simply that, when you read the manual as a whole – inclusive of the health warning that must be considered as a relevant qualification – HMRC are free not to apply the guidance in the BIM when tax avoidance is suspected.

The UT accepted HMRC's submission

The UT considered whether HMRC were reasonable in concluding that there might be tax avoidance. HMRC referred to various 'offshore' structural features that led the inspector to suspect that the Partnerships may migrate from the UK at a later date to allow non-resident or non-domiciled partners to then avoid tax on subsequent rental payments. His investigations led him to discover correspondence which he believed reinforced his view. The UT accepted that it was reasonable for the inspector to reach that conclusion based on the information available to him.

Although it was left unsaid, the natural interpretation of the judgment is that, where there are no reasonable grounds to suspect tax avoidance, taxpayers ought to be able to rely on the *BIM* if the structural features they have adopted accord with the plain vanilla example. This would apply even if those structural features have been deemed by the UT in the substantive appeal to be indicative of an uncommercial non-trading transaction.

Settled practice

Aside from statements published in the *BIM*, the Partnerships also relied on HMRC's conduct in entering into settlements with other film S&L partnerships where the reliefs were allowed – conduct that they argued amounted to a settled practice.

For a legitimate expectation to arise from settled practice, such a practice must be '… so unambiguous, so widespread, so well established and so well recognised as to carry within it a commitment to a group of taxpayers… of treatment in accordance with it' (*R (Davies) v R & C Commrs* [2011] UKSC 47).

In light of the UT's conclusion that HMRC were entitled not to apply the *BIM* where they suspected tax avoidance, establishing a settled practice would require evidence to show that HMRC had committed themselves not to take any points in a suspected tax avoidance case which it would not take in a straightforward tax deferment case. The UT noted the difficulty in establishing such a settled practice from HMRC's treatment of film S&L partnerships in general and, in light of the UT's view on the health warning included in the *BIM*, considered establishing one to be impossible.

Therefore, the UT dismissed the Partnerships' arguments that they had a legitimate expectation arising from the words (*BIM*) or conduct (settled practice) of HMRC.

Conspicuous unfairness

The Partnerships also argued that HMRC's conduct was so unreasonable so as to amount to an abuse of power (known as 'conspicuous unfairness'). The question was whether no reasonable body acting fairly could have acted as HMRC did.

Given that the UT accepted that the *BIM* must be read as a whole – HMRC were held not to have acted unfairly in this case, let alone so unfairly as to amount to an abuse of power. Hence, this argument was also rejected.

Conclusion

The FTT and the UT upheld HMRC's decision to deny the claims for statutory film reliefs based on certain features of the S&L transactions that the Partnerships had undertaken, features that are common to most, if not all, film S&L transactions in general and features that were included in the guidance in the *BIM*. Further, the

application for judicial review was rejected. In the UT's view, the Partnerships could not establish a legitimate expectation because there was enough evidence for the inspector to suspect tax avoidance.

Although HMRC have yet to give a view on their treatment of S&L transactions since this case, members of partnerships which undertook film S&L transactions that follow the guidance in the *BIM*, where there is no evidence to suggest that any subsequent steps will be taken to deviate from that guidance, so as to avoid tax, should be in a position to argue that they had a legitimate expectation that HMRC would grant them the reliefs.

Further information

Read 'Substantive appeal' on film reliefs from the July 2015 issue of Tax Adviser.