Stuck in second gear

Personal tax



01 December 2019

Keith Gordon discusses the Court of Appeal's approach to a taxpayer's reliance on a statement in HMRC's manuals

Key Points

What is the issue?

Aozora UK is attempting to quash an earlier decision by HMRC on the basis that the decision was inconsistent with a statement set out in HMRC's manuals on which the company had relied.

What does it mean to me?

The court seems to have adopted a test that HMRC may in fact resile from previous statements unless to do so would be 'so unfair as to amount to an abuse of power'.

What can I take away?

Subject to any further appeal, it would be appropriate for advisers, when carrying out their research, to make it clear when they have relied upon HMRC's statements of law.

In the January 2018 issue of *Tax Adviser*, I wrote an article 'Manual transmission' in which I considered the High Court's dismissal of a judicial review claim brought by Aozora GMAC Investment Ltd ('Aozora UK'). Aozora UK had sought to quash an earlier decision by HMRC on the basis that the decision was inconsistent with a statement set out in HMRC's manuals on which the company had relied. Aozora UK has since taken the case to the second stage, the Court of Appeal, in the hope that its case would find some more friends in that court.

The facts of the case

As noted in my earlier article, the precise facts are unlikely to interest most readers. A brief summary is set out in that article. For present purposes, I shall try to be even more concise.

Aozora UK's Japanese parent company sought advice on how to structure its group. Based upon a statement in HMRC's international tax manual, it incorporated Aozora UK and the UK company made tax returns based upon an interpretation of the law as set out in the manual. However, HMRC subsequently decided that they would adopt a less favourable interpretation and charged Aozora UK additional corporation tax through closure notices for three years. Aozora UK commenced judicial review proceedings so as to secure the advantage of the earlier interpretation, on the basis of which the group had taken commercial decisions and therefore had a 'legitimate expectation'.

In the High Court, the judge accepted that a statement in HMRC's manuals could amount to a statement on which a taxpayer could base a 'legitimate expectation' claim. Furthermore, he accepted that the statement in question was sufficiently

‘clear, unambiguous and devoid of any relevant qualification’ so that the taxpayer was ‘entitled in principle to rely on the guidance’.

However, the judge proceeded to dismiss the claim on the following bases:

1. The Aozora group had relied upon a UK-based adviser, whose advice made no reference to HMRC’s representations in the manual. Accordingly, the judge held that, on the evidence before him, there was no reliance by Aozora UK on the manual’s contents, but only on their professional advice.
2. Secondly, Aozora UK failed to adduce sufficient evidence to show that it would not have acted as it had done had the manual not made the statement now being relied upon. Accordingly, the judge held that Aozora UK had not cleared the ‘very high hurdle’ required to substantiate a case of alleged conspicuous unfairness.

The grounds of appeal

Aozora UK based its appeal on five grounds:

1. It was sufficient for Aozora UK’s adviser to have relied on the manual.
2. The adviser’s evidence did in fact show that he had relied upon the manual.
3. Aozora UK did not need to prove what advice would have been given by its adviser had it not been for HMRC’s representation in the manual.
4. Aozora UK did not need to provide express advice as to the course of action it would have followed had it not relied upon HMRC’s representation in the manual.

HMRC’s refusal to abide by its representations was indeed conspicuously unfair.

In response, HMRC challenged the judge’s conclusion that the statement in the manual was sufficiently clear on which Aozora UK could base a legitimate expectation claim.

The court’s decision

The case came before Lady Justice Rose (who gave the main judgment), and Lord Justice Underhill and Sir Bernard Rix, who both gave concurring judgments.
In respect of HMRC’s challenge, the court dismissed the assertion that the statement in the manual was not ‘clear, unambiguous and devoid of any relevant qualification’.

The statement relied upon could not be interpreted in any different way. Furthermore, there was no suggestion that the statement was being relied upon for the purposes of any tax avoidance, for which the manual contains an express carve-out.

Turning to Aozora UK's challenges, the court stated the company had to show that HMRC's departing from their previous statement amounted to 'a high degree of unfairness'.

The court disagreed with some of the approach taken by the High Court. Thus, whilst it agreed that one element of the balancing exercise was the extent to which Aozora UK had relied upon HMRC's manuals, it did not accept that there was any specific level of reliance that was necessary to allow a legitimate expectation claim to succeed. The alternative (that a certain threshold had to be crossed) was considered to be unrealistic and would be difficult for the courts to apply in practice.

The court also agreed with Aozora UK that a claim should not be dismissed simply because the person reading the statement was the taxpayer's adviser, rather than the taxpayer itself. Nevertheless, the court said that the fact that professional advice had been sought was still a relevant consideration when ascertaining the fairness question.

Despite taking a different view of the law from the High Court, the Court of Appeal considered the matters in the round and concluded that it was not unfair for HMRC to resile from their published view of the law. Ultimately, the court decided that the question of law was not particularly complex and, having sought professional advice, the professional adviser was in no worse a position than HMRC to reach a view. The company's appeal was therefore dismissed.

Commentary

In the circumstances of this case, it was perhaps surprising that HMRC even tried to suggest that the statement was not a clear one. In many other cases, HMRC's statements tend to be neutralised by being prefixed with 'Normally', so that it is not always easy to know whether HMRC are creating themselves some wriggle room. But that was not the case here. HMRC's attempts to suggest that manuals can never be relied upon seemed doomed to fail. Indeed, the court made it clear that such an argument would 'greatly reduce the value of HMRC's published guidance and greatly

increase the burden on taxpayers and their advisers trying to navigate their way through complicated legislation'.

Where I found some of the court's reasoning unclear was in respect of the underlying test of unfairness; i.e. when is the public body allowed to resile from its previous statements? The court appeared to start with the proposition that 'where a clear and unambiguous undertaking has been made, the authority making it [here HMRC] will not be allowed to depart from it unless it is shown that it is fair to do so'. The court also (helpfully, in my view) noted that different formulations of the fairness test have arisen in different contexts and that to pick out passages from earlier cases was not always helpful. Nevertheless, the above principle arose from a recent decision of the Supreme Court and was consistent with earlier Supreme Court authority, which required a decision maker to 'follow a published policy unless there are good reasons for not doing so'.

However, the court then turned to a recent Court of Appeal decision which held that: 'If HMRC finds that they need to resile from guidance, a taxpayer can only rely on the legitimate expectation that the guidance created where [to resile from it] would be so unfair so as to amount to an abuse of power.' In other words, after seemingly suggesting that HMRC cannot depart from a representation that they have made unless to do so would be fair, the court seems to have adopted a test that HMRC may in fact resile from previous statements unless to do so would be 'so unfair as to amount to an abuse of power'.

In my view, the latter formulation represents a wholly different test and, at the very least, affects the burden of proof. The court's justification for its approach seems to be based on the fact that, as a general principle, tax ought to be paid in accordance with the statute. However, I am not sure that taxpayers should be placed in a significantly different position when challenging HMRC from that of any other citizen seeking to hold a public authority to one of its statements. I hope that this will be clarified in due course.

In the meantime, the court has provided further confirmation that the concept of 'detrimental reliance' is not critical. In many cases, HMRC argue that a claim cannot succeed unless the taxpayer can show that detrimental action has been taken in reliance on HMRC's previous statement. That is not a correct statement of the law. Nevertheless, it is a factor that the courts will clearly take into account when assessing the question of fairness.

Finally, my instinct took issue with the court's view that Aozora UK's case was diminished by the fact that it had taken professional advice, as I was concerned that it would only encourage taxpayers to try to navigate the UK tax system unaided (a course of action that can hardly be considered to be sensible in most cases). However, I have since become somewhat more reconciled to the view, as the question then turns on to what extent it is reasonable in the circumstances for the adviser to have reached the same conclusion on the law as set out in the HMRC manual. Nevertheless, this is no doubt an area which I expect the courts to consider further.

What to do next

Subject to any further appeal, it would be appropriate for advisers, when carrying out their research, to make it clear when they have relied upon HMRC's statements of law; and, if a dispute later arises, to make it clear why it was reasonable for them to have relied upon such a statement and not carried out any further independent research.

In the meantime, it will be interesting to see whether Aozora UK will seek to apply for permission to appeal to the Supreme Court. Maybe the country's highest court will give them a break.