Legitimate expectations

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Crystal Randles-Mills and Claire Millard consider KSM Henryk Zeman and how it relates to arguing legitimate expectation in the First-tier Tribunal

Key Points

What is the issue?

Public law covers the conduct of public authorities when acting in public functions. The most common claims made in tax matters are either that HMRC has not made a decision properly or that the taxpayer had a legitimate expectation that their affairs

would be dealt with in a particular way.

What does it mean for me?

The Upper Tribunal decision in KSM Henryk Zeman v HMRC reopens the door to the assertion of public law rights in FTT proceedings. This may provide taxpayers with a more streamlined, timely and cost effective approach to resolving certain disputes on public law grounds.

What can I take away?

Going forward, taxpayers considering a public law challenge will need to carefully analyse the specific wording of the relevant sub-section under which an appeal may be brought before the FTT.

One of the longstanding issues in tax appeals concerns the jurisdiction of the First-tier Tax Tribunal. In some cases, taxpayers wish to claim that the tax authority, HM Revenue & Customs, has acted contrary to public law. Public law covers the conduct of public authorities when acting in public functions. The most common claims made in tax matters are either that HMRC has not made a decision properly or that the taxpayer had a legitimate expectation that their affairs would be dealt with in a particular way.

The way to challenge the actions of HMRC is to seek judicial review before the Administrative Court (part of the High Court). This is a problem, as it means that there are two separate appeal routes: to the Administrative Court to challenge the actions of HMRC on public law grounds; and to the First-tier Tribunal to appeal against a determination by HMRC. Employing both routes is costly and uncertain.

As a tribunal created by statute, the First-tier Tribunal has only those powers given to it by statute. These powers do not include a general ability to hear public law claims. However, there is a developing line of cases where the High Court and the Upper Tribunal have agreed (or disagreed) that the First-tier Tribunal may hear public law arguments in relation to particular statutory provisions. These arguments usually centre around whether the taxpayer has a ‘legitimate expectation’ that a certain tax treatment would apply.

The issue has a long history but had appeared largely settled following the Upper Tribunal decision in HMRC v Abdul Noor [2013] UKUT 71 (TC), with the conclusion that public law arguments in VAT cases fell only within the jurisdiction of the Administrative Court.

While the Upper Tribunal decision in KSM Henryk Zeman SP Z.o.o. v HMRC [2021] UKUT 182 (TCC) carries certain limitations, it reopens the door to the assertion of public law rights in FTT proceedings. This is a significant development, which may provide taxpayers with a more streamlined, timely and cost effective approach to resolving certain disputes on public law grounds – although general public law claims must go to the Administrative Court.

The history of public law arguments in the FTT

The Upper Tribunal in KSM fairly described the issue of the tribunal's jurisdiction to hear public law arguments as 'vexed', with a series of opposing, and seemingly irreconcilable, judgments.

In Oxfam v HMRC [2010] STC 686, the High Court (which at the time heard appeals from the VAT and Duties Tribunal (as it was) prior to the creation of the FTT and Upper Tribunal) held that the VAT and Duties Tribunal (now the FTT) had jurisdiction to determine a challenge on legitimate expectation grounds to an HMRC decision concerning input tax recovery. Section 83(1)(c) of the Value Added Tax Act 1994 permits an appeal to the FTT 'with respect to ... the amount of any input tax which may be credited to a person'. The court held that the phrase 'with respect to' was wide enough to permit the FTT to consider any question relevant to determination of the taxpayer's entitlement to input tax recovery. Further, jurisdiction should be determined by reference to the subject matter (in this case, the amount of input tax repayable) and not the legal regime or type of law.

The High Court held that there was no presumption that public law issues were reserved to the Administrative Court by way of judicial review proceedings. Instead, any court or tribunal has jurisdiction to consider public law issues to the extent that they are relevant to determination of questions falling within their statutorily defined jurisdiction. No specific language to that effect was required within the relevant legislative provisions.

In Noor, the Upper Tribunal took an opposing view, in respect of the very same legislative provision. It disagreed with Oxfam, concluding that the term 'with respect

to’ was not wide enough to include any and all legal questions relevant to the amount of input tax recoverable. The Upper Tribunal reasoned that the FTT’s jurisdiction under s 83(1) concerned rights and obligations under VAT legislation, and legitimate expectation is not a claim under that legislation. Further, s 83(1)(c) concerns, and is limited to, the amount of input tax repayable. A legitimate expectation could not impact on the amount of input tax, but rather whether (notwithstanding the proper VAT position) a repayment should nonetheless be made.

In Gore v HMRC [2014] UKFTT 908, the FTT held that it did not have jurisdiction to determine a challenge on the grounds of legitimate expectation under s 83(1)(p). This was on the basis that such jurisdiction would make the ‘best judgment’ requirement for assessments under s 73(1) – which allows a tribunal to consider the reasonableness of an officer’s decision to assess – redundant. The FTT considered that the phrase ‘with respect to’ in s 83(1) was not wide enough to extend the FTT’s jurisdiction to questions concerning HMRC’s discretion in issuing an assessment; rather it was limited to determining whether an assessment was properly made under the VAT Act 1994.

The issues in KSM

KSM’s appeal was concerned with whether statements made by HMRC gave rise to a legitimate expectation that KSM was not required to account for VAT on certain supplies, such that an assessment raised under VAT Act 1994 s 73(1) should be set aside.

On the facts, the Upper Tribunal decided that no legitimate expectation arose, and the assessment should stand. However, the judges nonetheless went on to set out in detail their views on the wider question of the FTT’s jurisdiction to adjudicate upon public law arguments in principle and in this context.

VAT Act 1994 s 83(1) prescribes the matters in respect of which an appeal may be brought before the FTT. KSM’s case concerned s 83(1)(p), whereby an appeal may be brought ‘with respect to … an assessment under s 73(1) … or the amount of such an assessment’. Section 73(1) provides that, where certain circumstances exist, HMRC ‘may assess the amount of VAT due from [the taxpayer] to the best of their judgment and notify it to him’.

HMRC argued that, as the FTT is a ‘creature of statute’, its jurisdiction must be established from the proper construction of the provision conferring the relevant jurisdiction upon it (in this case s 83(1)(p)). HMRC’s view was that s 83(1)(p) did not confer jurisdiction to challenge an assessment on public law grounds, and therefore KSM was not permitted to rely on any legitimate expectation in FTT proceedings.

KSM argued that the FTT’s jurisdiction is not limited to that bestowed by statute. Instead, common law principles should be assumed to sit behind the specific legislative provisions, with the result that the FTT is implicitly bound by public law principles and no explicit legislative language to this effect is required. If a decision of HMRC is contrary to public law, and in consequence ultra vires, the FTT must recognise the nullity of that decision.

The decision in KSM

The Upper Tribunal reiterated the established position that the FTT has no general supervisory jurisdiction (i.e. the power to review and re-make HMRC decisions on public law grounds). However, it took the view that it does not automatically follow that the FTT has no jurisdiction to hear challenges brought on public law grounds in respect of specific decisions.

First, it was necessary for the Upper Tribunal to consider the operation, in these circumstances, of the ‘exclusivity principle’ (the principle that public law arguments should only be heard by the Administrative Court, by way of judicial review). The Upper Tribunal referred to the Court of Appeal’s decision in the recent case of Beadle v HMRC [2020] EWCA Civ 562. In that case, the court held that where a public body brings enforcement action against a person in a court or tribunal, the rule of law and fairness require that the person in question is entitled to defend themselves by challenging the enforcement decision on public law grounds. An exception to this would arise only where the relevant statutory scheme explicitly, or by clear and necessary implication, excluded such a challenge.

In an appeal against a VAT assessment, the Upper Tribunal in KSM considered that a taxpayer was, in substance, defending against enforcement action brought by HMRC. Accordingly, following Beadle, the Upper Tribunal concluded that the starting point is that a public law challenge against an assessment is within the jurisdiction of the FTT, unless the relevant statutory scheme provides otherwise.

Turning to the construction of s 83(1)(p), and whether it excludes from the FTT's jurisdiction public law challenges, the Upper Tribunal noted that such construction must be conducted in the context of other statutory provisions to which that jurisdiction relates. Accordingly, in this case, the wording of both s 83(1)(p) (the provision giving the tribunal the jurisdiction to hear appeals relating to assessments) and s 73(1) (the provision giving HMRC the power to raise an assessment) was relevant.

The tribunal agreed with the conclusion in Oxfam that the ordinary and natural meaning of the phrase 'with respect to' at s 83(1) requires that the scope of the FTT's jurisdiction be determined by reference to the subject matter of the sub-section in question, not the particular legal regime or type of law. The subject matter of s 83(1)(p) is an assessment or the amount of an assessment to VAT. It is clear from the permissive nature of HMRC's power to assess under s 73(1) ('they may assess the amount of VAT due') that, in order for there to be an assessment, HMRC must have made a decision that there should be one.

Given that an assessment is therefore an exercise of HMRC's discretion, and legitimate expectation in this context concerns the question of whether a decision to assess should or should not have been made, the Upper Tribunal held that it is difficult to see how the legislation excluded a taxpayer challenge to an assessment on legitimate expectation grounds.

Further, it noted that HMRC's position would require a distinction to be drawn between a decision to assess (in respect of which, according to HMRC, the FTT would not have jurisdiction) and the process of deciding to assess by reference to best judgment (in respect of which the FTT clearly did have jurisdiction). The Upper Tribunal considered that the legislation could not be readily interpreted to support that proposition and voiced its concerns as to the workability of such a conclusion in practice.

Finally, the Upper Tribunal noted a number of factors which supported a conclusion that it was in both the public interest and the interests of justice for the FTT's jurisdiction to extend to public law arguments, where appropriate. These included:

- the risk of duplication, delay and injustice that may arise where there is potential for dispute over the correct forum for a particular challenge;

- the difficulty and expense of bringing a judicial review and the risk of injustice in respect of the ability of a private person to enforce their rights if that is the only action available to them;
- the fact that FTT proceedings, encompassing determination of associated public law arguments, are likely to produce certainty on the final tax position at an earlier stage than a judicial review; and
- the fact that there is no wider public significance to an FTT decision in respect of a particular taxpayer's circumstances, on the basis that decisions of the FTT are not binding in future cases.

Accordingly, the Upper Tribunal concluded that: 'We do not consider that s 83(1)(p) does exclude that ability [to bring a challenge on legitimate expectation grounds before the FTT]. On the contrary, on the facts of this case and given the broad subject matter of s 83(1)(p), we see strong reasons for thinking that it would be artificial and unworkable to exclude a defence based on the public law principle of legitimate expectation from the tribunal's appellate jurisdiction. We therefore consider that the FTT did have jurisdiction to determine that question in this case.'

Implications

While this is a welcome development for taxpayers, the decision in KSM should not be construed as negating the role of judicial review in the Administrative Court in VAT and other tax disputes where the taxpayer considers that public law arguments are in play (i.e. those that address the apparent 'fairness' of an HMRC decision beyond the tax technical position).

The Upper Tribunal specifically noted that the bases for appeal set out in VATA 1994 s 83(1) are expressed differently, and that cases will differ depending on the specific statutory language in question. The analysis, however, clearly conceived that there would be circumstances in which that language excluded a taxpayer's right to plead public law arguments in the FTT but that regard must be had to the relevant statutory provision giving the FTT jurisdiction.

Notably, while the Upper Tribunal agreed with the analysis of the High Court in Oxfam as to the scope of the term 'with respect to', it did not specifically comment on the subsequent conclusion in Noor that public law grounds could not be raised under s 83(1)(c). Instead, the Upper Tribunal noted that the scope of s 83(1)(p) is wider than that of s 83(1)(c), providing a basis on which future tribunals may

conceivably conclude that the outcomes in both Noor and KSM are correct, and reconcilable with one another.

Going forward, taxpayers considering a public law challenge will need to carefully analyse the specific wording of the relevant sub-section under which an appeal may be brought before the FTT. In light of KSM, the key question will be to consider whether the wording and context of that provision excludes (explicitly or by implication) from the FTT's jurisdiction a challenge brought on public law grounds. Where any uncertainty remains, a taxpayer would be well advised to continue to bring an application for judicial review in parallel to any appeal, to protect its position.

It is not yet known whether HMRC will appeal the KSM decision (which is unlikely, given that the judgment was in favour of HMRC). In any event, and notwithstanding that this decision is binding on at least the FTT, it is likely that this will continue to be an evolving area of law.