VAT focus

Great expectations? VAT and legitimate expectation

Speed read

Recent cases have clarified the circumstances in which the taxpayer has a legitimate expectation in the context of VAT. Such circumstances are now more readily identifiable and, where they arise, taxpayers should be encouraged to bring a claim for judicial review. However, the correct forum in which to bring such a claim is not always clear and care is therefore required in order to avoid either losing the right to bring a claim or incurring unnecessary costs.

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Legitimate expectation is of critical importance in the context of VAT. Taxpayers will naturally rely to some extent on HMRC's published notices, manuals and concessions but may also have obtained specific clearances (or rulings) to aid them in applying the correct tax treatment to their business transactions. In addition to such guidance, they may also have regular contact with HMRC in the form of inspections or investigations which may provide some degree of confidence that their business affairs are VAT compliant.

It may therefore come as an unpleasant surprise if HMRC subsequently challenge a taxpayer's VAT treatment and seek to assess them in relation to transactions going back a number of years. In such circumstances, the taxpayer might choose to argue not only that their tax treatment is correct but also that in any event HMRC should be prohibited from assessing them where the taxpayer has relied upon some form of representation or assurance that their past treatment was correct and that it would be highly unfair for HMRC to alter their view. This is the essence of breach of legitimate expectation.

Ten years ago there were a mere handful of cases in which taxpayers had successfully challenged HMRC decisions by means of judicial review. Recently, however, taxpayers have been finding success more frequently when making public law arguments, particularly legitimate expectation. The purpose of this article is to consider recent case law refinements to the law and practice relating to legitimate expectation in the context of VAT.

Fundamentals

The scope of legitimate expectation in the tax context is closely-guarded by the Courts. It is a truism that HMRC is a public body invested with the power to collect tax, taxpayers must expect to pay the right amount of tax, and therefore a taxpayer's only legitimate expectation is, prima facie, that they will be taxed according to statute, not concession or a wrong view of the law (*MFK Underwriting Agents* [1990] 1 WLR 1545; *Hely-Hutchinson* [2017] EWCA Civ 1075). In order to establish a legitimate expectation capable of creating an exception to these principles, the taxpayer will generally need to establish a number of elements, principally that:

- through words or conduct, HMRC must have made a representation or given some form of assurance which was clear, unambiguous and devoid of relevant qualification;
- the taxpayer must be within the class of people to whom the representation was made (or it must otherwise be reasonable for them to rely upon it);
- in obtaining the representation, the taxpayer must put all their cards face up on the table by giving full details of the specific transaction on which a ruling is sought; and
- the taxpayer must demonstrate a high degree of unfairness in order to override the public interest in HMRC collecting taxes in accordance with the law.

It is not strictly necessary for the taxpayer to prove that they have relied on the representation to their detriment in order to demonstrate a high degree of unfairness. However, in practice the presence or absence of detrimental reliance often proves decisive when the court comes to determine the degree of unfairness that would be suffered by the taxpayer.

As the cases below illustrate, the manner in which the courts apply the above principles varies depending on the nature of the representation provided. For example, the need for a taxpayer to demonstrate full and frank disclosure will be more significant where a taxpayer is relying on a non-statutory clearance than if they are relying on a published concession. In a VAT context, representations made by HMRC may usefully be considered under three headings: (i) published policies and concessions, (ii) clearances, and (iii) investigations and implied representations.

Published policy and concessions

It is well established that extra-statutory concessions and HMRC published policy are capable of giving rise to claims for legitimate expectation. It is generally more straightforward for a taxpayer to rely on such published statements because:

- Since concessions are generally published to the world, any taxpayer who meets the conditions of the concession is within the class of people to whom the representation has been made. As held in *MFK* [1990] 1 WLR 1545, 'a statement formally published by the Inland Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them'.
- In principle the same applies in relation to general statements of HMRC policy such as business briefs, notices or HMRC manuals (for example, *Vacation Rentals (UK) Ltd* [2018] UKUT 383 (TCC)).
- There is generally no need for a taxpayer to show that they have made full and frank disclosure because the representation is obtained without any interaction with HMRC. It should be noted, however, that in some circumstances the courts have considered that a failure to seek clarification from HMRC on the application of the relevant statement may reduce the unfairness suffered by the taxpayer.

- Detrimental reliance can be less significant in the context of a published concession, but still assists in demonstrating a high degree of unfairness if HMRC act inconsistently with a published statement.

Furthermore, the condition that the representation must be 'clear, unambiguous and devoid of relevant qualification' is generally applied by reference to the effect of the representation rather than its terms. By their nature concessions and policy statements should be clear and unambiguous in terms of their effect and the fact that taxpayers can rely upon them, and they are generally devoid of relevant qualification, save that they may not be relied upon for the purposes of avoidance or abuse.

When it comes to the interpretation of a published concession or policy, ambiguity is not a barrier to a taxpayer claiming its benefit. The court should approach the publication by seeking to identify the correct (i.e. better) interpretation by asking how, on a fair reading of the statement, it would reasonably be understood by the 'ordinarily sophisticated taxpayer' (for example, *Aozora GMAC Investment* [2019] EWCA Civ 1643).

> *Airline Placement* serves as a cautionary tale to taxpayers seeking rulings and clearances: unless all facts that carry a real possibility of changing HMRC's decision are disclosed, the ruling or clearance will provide no protection whatsoever

This approach was applied by the High Court in *Royal Surrey NHS Foundation Trust* [2023] EWHC 2354 (Admin), a case concerning a concession applicable to NHS Trusts allowing them to claim a sum equivalent to input VAT on transactions within the NHS VAT Division. Even though HMRC contested the meaning of the concession, the court preferred the taxpayer's interpretation and held that, properly construed, they fell within the scope of the concession. For an emphatic application of this approach (albeit in a direct tax context), see *Murphy and Linnett* [2023] EWCA Civ 497 in which the High Court had interpreted the relevant concession in HMRC's favour but the Court of Appeal reversed the decision preferring the taxpayers' interpretation: the concession's ambiguity was not a reason to prevent the taxpayer relying on a (correctly interpreted) published statement.

However, it is essential that the taxpayer can demonstrate that they fall within the class of taxpayers to whom the relevant statement is addressed. The taxpayer in *Glint Pay Services Ltd* [2023] EWHC 1621 (Admin) failed this condition because the Court held that, properly construed, the concession was intended to assist members of the London Bullion Market Association and London Platinum and Palladium Market (the taxpayer was a member of neither).

Clearances

If a taxpayer receives a specific view from HMRC as to the tax treatment of particular transactions, then they are in a good position to argue that they have a legitimate expectation. However, in such cases the critical issue may be whether or not the taxpayer gave 'full and frank disclosure' when obtaining the ruling or clearance. This is not limited to a situation in which the clearance request was inaccurate or misleading, but may simply arise from the fact that relevant material was inadvertently omitted.

It has previously been suggested that the correct approach to identifying whether or not an inaccuracy or omission will prevent a legitimate expectation arising from a clearance is to ask whether the information was 'essential to HMRC's deliberations' (for example, *Matrix Securities Ltd* [1994] 1 WLR 334). This approach has been refined in *Airline Placement Ltd* [2023] EWHC 1191 (Admin): in that case, the taxpayer provided a training scheme for pilots which required the cadet to deposit a security bond which could be forfeited in the event of early termination. The taxpayer had obtained a non-statutory clearance determining that the payment of the security deposit was not a supply for VAT purposes. Years later, HMRC withdrew the non-statutory clearance and issued assessments, which the taxpayer challenged by way of judicial review. The principal issue before the court was whether or not full and frank disclosure had been given when seeking the non-statutory clearance.

The court gave careful consideration to the degree to which a failure to provide information would justify the withdrawal of a clearance. It concluded that 'the Court must consider on the ordinary standard of balance of probabilities, had the NSC Request not been inaccurate, whether there is a real possibility that consideration of the matter as corrected would have made a difference to the decision.' In the court's view, the failure of the taxpayer to explain various matters relevant to the way the security bond was funded (in particular, through salary sacrifice arrangements), resulted in the clearance providing no legitimate expectation. *Airline Placement* serves as a cautionary tale to taxpayers seeking rulings and clearances: unless all facts that carry a real possibility of changing HMRC's decision are disclosed, the ruling or clearance will provide no protection whatsoever.

Investigations and implied representations

It is the nature of a self-assessment regime that a taxpayer may file returns applying a particular treatment or adopt a particular procedure for many years without challenge (the facts of *Unilever Plc* [1996] STC 681 being a particularly notable example in which HMRC had accepted late claims for more than 20 years). It may even be the case that HMRC periodically carry out inspections or investigations that provide some form of implied confirmation of the taxpayer's treatment. If HMRC later seek to assess the taxpayer for past periods, can the taxpayer argue that HMRC's previous acceptance gives rise to a legitimate expectation?

This was the issue in *Realreed* [2023] EWHC 1572 (Admin): since 1989, the company had treated its business as being partially exempt on the basis that its supplies of serviced accommodation were exempt. In 2019, HMRC challenged the treatment of the supplies and issued assessments going back four years. This was done notwithstanding the fact that over the 30 intervening years the business had been subject to a number of inspections which had sometimes resulted in amendments to its partial exemption calculations.

The taxpayer argued that it had a legitimate expectation because HMRC had implicitly represented over the years that they accepted that the company's supplies were exempt. It also sought to raise a separate challenge of substantial unfairness – but the court confirmed that this is not an independent ground for judicial review and the taxpayer's only possible ground for challenge was legitimate expectation.

The court did not accept that HMRC had given representations which might give rise to a legitimate expectation on the grounds that none of the inspecting officers had carried out a critical examination of the relevant issue, namely whether the supplies were exempt from VAT; nor had the company asked HMRC for any assurance regarding those supplies.

The court observed that the taxpayer's view that the supplies were exempt had been formed before any of the inspections occurred and the business had not demonstrated that it would have done anything differently absent the VAT inspections. In assessing unfairness, the court in *Realreed* therefore applied a causative test that the taxpayer had to prove that it would have acted differently absent the alleged assurance.

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How should an argument for legitimate expectation be raised?

Where the taxpayer does have arguable grounds for arguing legitimate expectation, consideration must be given to how and in what forum the taxpayer can raise their argument. The majority of HMRC decisions may be subject to an appeal to the First-tier Tribunal, but if the taxpayer's public law argument does not fall within the tribunal's jurisdiction it will need to be the subject of separate judicial review proceedings. This may result in parallel challenges to the same HMRC decision proceeding before the First-tier Tribunal and the Administrative Court.

Identifying the correct forum is of critical importance:

- If the taxpayer fails to apply for judicial review, the tribunal may decide that it does not have jurisdiction to consider the relevant public law argument and strike out that part of their appeal. If (as is likely) the taxpayer is out of time to bring a claim for judicial review (the time limit being three months from the date of the decision being challenged) then they may have lost their opportunity to raise the argument at all.
- On the other hand, if a taxpayer brings a claim for judicial review when in fact the argument is within the tribunal's jurisdiction then their application for judicial review will be refused permission on the basis that they have an alternative remedy (which is likely to mean that costs have been wasted pursuing futile proceedings). (Note: some clients assume that the costs of bringing a claim for judicial review will be high; this is not necessarily the case, albeit it is true that the costs tend to be frontloaded compared to a tribunal appeal.)

The key question is whether the tribunal has jurisdiction to consider public law arguments – but the answer to this question varies depending on the particular statutory context. Prior to 2021, the orthodox view was that, in relation to the vast majority of VAT appeals concerning repayment claims and assessments, the tribunal's jurisdiction was limited to the application of the relevant tax legislation and did not extend to the supervision of HMRC's conduct (for example, *Marks & Spencer* [1999] STC 205, *Noor* [2013] UKUT 71 (TCC) and *Metropolitan International Schools* [2019] EWCA Civ 156). In 2018, the recommendations made by the Economic Affairs Committee of the House of Lords in its report *The powers of HMRC: treating taxpayers fairly* actually included that the government legislate to grant the First-tier Tribunal judicial review powers – but this recommendation was flatly rejected.

However, the Upper Tribunal in *KSM Henryk Zeman* [2021] UKUT 182 (TCC) created some uncertainty by concluding that the FTT did have jurisdiction to determine the taxpayer had a legitimate expectation argument in the context of an appeal against an assessment (under VATA 1994 s 83(1)(p)). The grounds for this decision included that the making of an assessment is a discretionary power and therefore there was no reason to exclude the availability of a general public law defence in relation to that administrative act. This decision has given rise to a number of optimistic arguments being pursued in the FTT, often where the taxpayer was out of time to issue proceedings in the High Court.

Subsequent decisions such as *Caerdav Ltd* [2023] UKUT 179 (TCC) have not doubted the correctness of *Zeman* but rather have declined to extend its application outside of the specific provision in issue in *Zeman*. As stated by the Upper Tribunal in *Caerdav*, when considering whether the tribunal has the jurisdiction to consider public law arguments 'the statutory context is key'. The relevant question is whether the tribunal is required to determine the issue of public law in order to exercise its statutory jurisdiction under the legislation in issue.

This approach results in uncertainty for taxpayers and, until the courts provide further clarification, claimants seeking to rely on legitimate expectation in relation to VAT assessments will need to consider their position carefully and might decide to protect their position by commencing both a statutory appeal and a claim for judicial review.

It may be worth noting that in none of the recent High Court cases considered above have HMRC argued (or the court held) that the taxpayer had an alternative remedy of appealing to the tribunal. In practice it therefore appears that, notwithstanding the potential expansion of the tribunal's jurisdiction suggested in *Zeman*, the High Court is content to continue to determine taxpayers' legitimate expectation arguments.

Encouragement for taxpayers?

Recent cases confirm that, whilst the conditions for claiming legitimate expectation remain circumscribed, they are now more clearly identifiable – particularly where a taxpayer relies on a concession or statement of policy published by HMRC, or on a clearance obtained following full and frank disclosure. The discussion of and refinements to the applicable principles in the recent case law is therefore to be welcomed as they provide greater certainty for taxpayers seeking to raise such arguments and guidance on how the courts will seek to strike the balance between HMRC's tax collecting function and taxpayers' legitimate expectations in future cases. Notwithstanding the challenges of determining the correct forum in which to bring a claim, overall, this should provide encouragement for taxpayers in the appropriate circumstances to pursue legitimate expectation arguments. ■

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- Holding HMRC to a statement (J Landman & A McGregor, 30.6.23)
- The doctrine of legitimate expectation in *Aozora* (S Daly, 24.10.19)
- Are retrospective assessments permissible when HMRC didn't question the tax treatment during prior inspections? (S Walsh & N Oji, 26.7.23)