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# PUBLIC LAW CHALLENGES TO HMRC

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1. According to widely published research1 judicial review challenges to HMRC's exercise of powers is substantially on the rise. It is up from 42 applications in 2014, to 76 in 2015 to 90 in 2016.

2. This is still a relatively low amount, reflecting the fact that an appeal to the tax Tribunals remains the primary means of challenging HMRC. As the Court of Appeal has recently reaffirmed, the existence of that statutory right of appeal will preclude judicial review save in an exceptional situation (*Glencore Energy UK Ltd v HMRC* [2017] EWCA Civ 1716).

3. Nevertheless, those exceptional situations are becoming more common. Recent years have seen the pressures on HMRC to collect tax. That has resulted in a more aggressive approach to existing powers, as well as legislation conferring an array of new powers, many of which are not subject to appeal.

## Challenges to APNs

4. A lot of the challenges which have been brought in recent years have concerned accelerated payment notices (APNs). Those challenges have necessarily been brought by way of judicial review as there is no statutory mechanism for appeal.

5. To date there have been at least 4 reported decisions on challenges to APNs all of which are currently on appeal to the Court of Appeal:

   a) *The Queen on the application of Rowe and ors v The Commissioners for Her Majesty's Revenue and Customs*

   b) *The Queen on the application of Vital Nut Co Limited and Ors v The Commissioners for Her Majesty's Revenue & Customs*

[1] The following details are taken from an article in the Financial Times by Venessa Houlder dated June 26 2017 and an article in Accountancy Age, also dated June 26 2017 by Allia Shoaib

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c) *The Queen on the application of Walapu v The Commissioners for Her Majesty's Revenue & Customs*

d) *The Queen on the application of Dickinson & Ors v Her Majesty's Revenue and Customs*

6. The Court of Appeal (Arden LJ, Flaux LJ and Thirdlwall LJ) heard appeals in *Rowe* and 18 July 2017*Vital Nut* on 18 and 19 July 2017.

7. As at the date of writing we are awaiting the judgment of the Court in those appeals. Appeals. *Walapu* is waiting on that decision and a decision on leave is being awaited in *Dicknson*. There are also in numerous other cases stayed behind *Rowe*.

8. In light of this, I do not propose to address these challenges to HMRC in this talk (although they are likely to be addressed in the next Old Square Tax Chambers Seminar on 30 January 2018).

**HMRC guidance**

9. A second fertile area of public law challenge to HMRC action is where a taxpayer seeks to rely on HMRC guidance which HMRC subsequently asserts has no application.

10. The classic statement of the law in this area was provided by Bingham LJ in *R v IRC, ex p MFK Underwriting Agencies Ltd* [1989] STC 873 at 892:

> *'I am, however, of opinion that in assessing the meaning, weight and effect reasonably to be given to statements of the Revenue the factual context, including the position of the Revenue itself, is all important. Every ordinarily sophisticated taxpayer knows that the Revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayer's only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law ... No doubt a statement formally published by the Revenue to the world might safely be regarded as binding, subject to its terms, in any case falling clearly within them. But where the approach to the Revenue is of a less formal nature a more detailed inquiry is, in my view, necessary. If it is to be successfully said that as a result of such an approach the Revenue has agreed to forego, or has represented that it will forego, tax which might arguably be payable on a proper construction of the relevant legislation it would, in my judgment, be ordinarily necessary for the taxpayer to show that certain conditions had been fulfilled. I say "ordinarily" to allow for the exceptional case where different rules might be appropriate ... First, it is necessary that the taxpayer should have put all his cards face upwards on the table ... Secondly, it is necessary that the ruling or statement relied upon should be clear, unambiguous and devoid of relevant qualification.'*

11. Although *MFK* did not concern a Revenue publication, this approach was held to apply equally to such a publication in *R (on the application of Davies) v Revenue and Customs*

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*Comrs; R (on the application of Gaines-Cooper) v Revenue and Customs Comrs* [2011] STC 2249 (see paras 28 and 29). Ultimately, however, the case turned on the meaning of IR20 and whether it covered the taxpayer's circumstances.

12. Nevertheless, the importance of HMRC guidance was fully recognised, with Lord Wilson beginning his analysis:

> *There can be no better introduction to this section than in the words of Moses LJ in his judgment in the decision under appeal ([2010] STC 860 at [12]):*
>
> > *'The importance of the extent to which thousands of taxpayers may rely upon guidance, of great significance as to how they will manage their lives, cannot be doubted. It goes to the heart of the relationship between the Revenue and taxpayer. It is trite to recall that it is for the Revenue to determine the best way of facilitating collection of the tax it is under a statutory obligation to collect. But it should not be forgotten that the Revenue itself has long acknowledged that the best way is by encouraging co-operation between the Revenue and the public ... Co-operation requires fair dealing by the Revenue, and frank and open dealing by the public. Of course the Revenue may refuse to give guidance and re-create a situation in which the taxpayers and their advisers are left to trawl through the authorities to find a case analogous to their own, or, if they are fortunate, a statement of principle applicable to their circumstances. But since 1973, in a field fraught with borderline cases relating to an enormous variety of circumstances, the Revenue has chosen to confer what presumably it regarded as a benefit on taxpayers who wished to know whether they were likely to be treated as resident or not.'*

13. In a similar vein in *Samarkand Film Partnership No 3 and others v Revenue and Customs Commissioners* - [2017] STC 926 the public law issue turned on whether certain passages of the HMRC Business Income Manual covered the situation. Henderson LJ's starting position was that this would be unlikely:

> *Although it is now well established that the doctrine of legitimate expectation in public law can extend to substantive as well as procedural expectations, and can in an appropriate case prevent a public body, including HMRC, from applying the law correctly where to do so would frustrate the claimant's expectation, experience shows that the cases where such a claim has succeeded, at any rate in the field of taxation, are relatively few and far between. This is in my view hardly surprising. There is a strong public interest in the imposition of taxation in accordance with the law, and so that no individual taxpayer, or group of taxpayers, is unfairly advantaged at the expense of other taxpayers. There is also a real public interest in the Revenue making known the general approach which it will adopt, and the practice which it will normally follow, in specific areas. The publication of the BIM is a good example of this principle in operation. But there are likely to be few cases where a taxpayer can plausibly claim that a representation made in general material of this nature is so clear and unqualified that the taxpayer is entitled to rely on it and to be taxed otherwise than in accordance with the law.*

14. He ultimately concluded that such representations as were present in the BIM were subject to the caveat that they would not apply in the case of tax avoidance, and that this

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prevented a legitimate expectation from arising. In the words of Bingham LJ the representation could hardly be said to be "devoid of relevant qualification".

15. The decision of the Court of Appeal in *R (on the application of Hely-Hutchinson) v Revenue and Customs Commissioners* - [2017] STC 2048 is potentially more significant as it turns not on the scope of the guidance, but rather on the circumstances when guidance can properly be relied upon.

16. The facts were as follows:

    a) Mr H-H was granted share options by reason of employment. He exercised them realising a gain on which he paid income tax (by reference to their market value). He also sold them immediately but assumed that there was neither a gain nor a loss as base cost was calculated as being (i) the cost of acquisition of the option (ii) any cost on exercise of the option and (iii) any sum on which income tax was payable under section 135 ICTA 1988 (section 120 TCGA 1992).

    b) In *Mansworth v Jelley* [2003] STC 53 the Court of Appeal held that the combined effect of sections 17 and 144 TCGA was that shares acquired pursuant to an employment related share option were deemed to have been acquired for a consideration equal to the market value of the shares as at the date of the exercise of the share option. The Court of Appeal did not consider those parts of the TCGA 1992 dealing with income tax on the exercise of such options. That is because they were not in point (as the taxpayer was non-resident when he acquired the options).

    c) HMRC issued guidance ("the 2003 Guidance") stating that the base cost of employment related share options was e base cost for the acquisition of the shares was the market value of the shares (as per *Mansworth v Jelley*) plus any income tax incurred on their acquisition (as per section 120 TCGA 1992).

    d) Parliament introduced section 144Z TCGA 1992 with a view to reversing the effect of the 2003 Guidance.

    e) Mr H-H like many other taxpayers in a similar position made claims for capital losses based on the 2003 Guidance.

    f) Some months later HMRC opened an enquiry into Mr H-H's claims. This was in the context of an enquiry into his employer (a bank) which had apparently issued the options as part of an employer's NIC avoidance arrangement. The evidence indicated that there were many other employees outside the financial sector who had successfully

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made claims without enquiry.

g) HMRC held off on addressing Mr H-H's enquiry while it dealt with his employer and indeed other employers who had entered into similar arrangements.

h) In 2009 HMRC issued further guidance ("the 2009 Guidance") in which it expressed the view that the acquisition cost of the shares was their market value (in effect that section 120 TCGA 1992 is to be ignored).

i) HMRC ultimately refused Mr H-H's capital losses by applying its 2009 Guidance. He challenged that decision by way of judicial review.

17. HMRC's position was that it would be bound by the 2003 Guidance if Mr H-H could show detriment. However, it also adopted the position that once an enquiry had been opened Mr H-H could have no expectation of the guidance being applied to him. The fact that the situation had been ongoing for a period of years was irrelevant.

18. Before Whipple J Mr H-H succeeded. It was accepted (as it was before the CA) that the 2003 Guidance gave Mr H-H a legitimate expectation. Furthermore, she accepted that it would be unfair to frustrate that expectation given that other taxpayers in the same position had been given the benefit of the 2003 Guidance and continued to be able to use their claims which were protected under section 29(2) TMA 1970. That comparative unfairness had not been addressed by HMRC which was required to consider all aspects of unfairness. Accordingly the closure notice was quashed and the matter remitted to HMRC for further consideration.

19. The CA took a different approach.

20. Although there was no question that Mr H-H had a legitimate expectation, on the question of whether it was lawful to frustrate it Arden LJ stated:

> *"... it is well established that it is open to a public body to change a policy if it has acted under a mistake. The decision whether or not to do so is not reviewed for its compatibility in the public interest: the question is whether or not there has been sufficient unfairness to prevent correction of the mistake. It is clear from the authorities that the unfairness has to reach a very high level: see, in particular, the holding of Simon Brown LJ in Unilever where he held that it was not enough that the change of course by the public body was "mere unfairness" or conduct which was "a bit rich". It had to be outrageously or conspicuously unfair."*

21. That appears to place the bar somewhat higher than in previous cases. Lord Woolf MR *R v North and East Devon Health Authority, Ex parte Coughlan* [2001] QB 213 had put the position in terms that:

> *"... once the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy".*

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22. As regards comparative unfairness, Mr H-H had argued that HMRC could not single him out for different treatment (by opening an enquiry), and then argue that it was entitled to treat him differently precisely because it had chosen to treat him differently. The correct comparator was with all of those who had made claims in accordance with the 2003 Guidance (i.e. those who had exercised employment related share options before the law changed and were in time to make claims). The CA disagreed.

23. It held that it was open to change its policy with good reason, and while consistency was desirable a public body was not bound to maintain a mistaken position.

24. As regards comparability, it was not enough that the Mr H-H and others were in a comparable position when he made his claim. The situation had to be considered at the time when HMRC made its decision, and because the other taxpayers were protected at that point in time, they were not in a comparable position.

25. More generally, because Mr H-H did not expect to get the benefit of the losses when he exercised his options, and was returned to that position, he was not in a position to show conspicuous unfairness.

26. The decision is likely to have an impact on appeals currently before the CA, including *City Shoes* and *Veolia*, both of which are being heard in December.

27. Assuming it stands unamended (an application for permission has been made to the Supreme Court) it does appear to raise the bar significantly for taxpayers seeking to rely on HMRC guidance, and perhaps also specific HMRC assurances. The requirement that treatment be outrageously or conspicuously unfair has been subsumed within the legitimate expectation head of review, and if it remains there, will present a difficult obstacle for any taxpayer arguing the position.

**Assessment and liability**

28. There is a distinction to be drawn between liability to tax and an assessment of that tax. As Lord Dunedin stated in *Whitney v IRC* [1926] AC 37 at 52

> *'Now, there are three stages in the imposition of a tax: there is the declaration of liability, that is the part of the statute which determines what persons in respect of what property are liable. Next, there is the assessment. Liability does not depend on assessment. That, ex hypothesi, has already been fixed. But assessment particularizes the exact sum which a person liable has to pay. Lastly, come the methods of recovery, if the person taxed does not voluntarily pay.'*

29. While liability is determined by statute, an assessment will often require an action on the part of the taxing authority. The exercise and scope of the power to assess is something which has been the subject of challenge in a number of recent cases. While the most common scenario concerns

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the power to issue a discovery assessment, disputes on the issue have not been so limited.

30. In *HMRC v Benham (Specialist Cars) Ltd* [2017] UKUT 0389 (TCC) HMRC purported to amend a company tax return on the basis that a declaration for roll over relief had ceased to have effect. The taxpayer argued that the correct course was for HMRC to issue a discovery assessment (which would have put it in a position to make consequential claims) whereas HMRC argued that there was a freestanding power within TCGA 1992 allowing it to amend an assessment.

31. The Upper Tribunal noted the lack of procedural safeguards supporting HMRC's approach, most particularly there would be no right of appeal. It concluded that Schedule 18 FA 1998 provides an exhaustive code for making and amending assessments.

32. A second issue was whether the stated amendment should be treated as being a discovery assessment which HMRC argued it was (in substance). That was rejected by the Upper Tribunal on the basis that it was clearly intended to be an amendment of an assessment with different consequences and that a taxpayer is entitled to know in the face of the decision, the nature of the decision addressed against him.

33. Another procedural irregularity in the assessing procedure arose in *GB Housely Ltd v HMRC* [2017] STC 508 which involved a supervisory jurisdiction. The Upper Tribunal having agreed that an HMRC assessment was invalid for failure to exercise a discretion nevertheless went on to make directions for that discretion to be exercised with the matter to be remitted for the FTT to reconsider matters the validity of the assessment at that point, on grounds that if the discretion would have made no difference the assessment could be upheld.

34. The CA concluded that this approach was wrong. If the assessment was bad for want of exercise of discretion, the appeal fell to be discharged. HMRC should not have been afforded an opportunity to retrospectively justify their approach.

35. A third challenge was to the validity of closure notices in *R (Archer) v HMRC* [2017] STC 1037. The challenge by way of judicial review was against closure notices which did not state the amount of tax due. Although Jay J accepted that the closure notices were defective as they failed to state the amount of tax due, they nevertheless gave rise to an appealable decision under section 31(1)(b) TMA 1970. On such an appeal, the FTT could cure the defects in the closure notice using its powers to save errors in section 114 TMA 1970. Accordingly, the correct course was to appeal the decision rather than to bring a judicial review.

36. A similar procedural point arose in *Glencore Energy UK Ltd v HMRC* [2017] EWCA Civ 1716 which concerns diverted profits tax. The essential complaint was that the statutory review and appeal procedure was not a suitable alternative remedy as it would see the appellant company out of its money for some considerable period of time.

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37. Judicial review was refused, on grounds that it is "a remedy of last resort, to ensure that the rule of law is respected where no other procedure is suitable to achieve that objective". Furthermore "To allow judicial review to intrude alongside the appeal regime risks disrupting the smooth collection of tax and the efficient functioning of the appeal procedures in a way which is not warranted by the need to protect the fundamental interests of the taxpayer"

38. More unusual to assessment challenges are those based upon an absence of the power to tax at all. That was a central issue in *Vrang v Revenue and Customs Commissioners* - [2017] STC 1192 where money had been deducted from the Claimant's account in Switzerland and paid to HMRC in the UK under the UK/Swiss tax agreement. The sums deducted vastly exceeded any UK tax liabilities and it was argued that Parliamentary authority was required for this. Although there was provision dealing with the consequence of the tax agreement in Schedule 36 FA 2012, nothing explicitly provides for the imposition of a charge. It was in effect assumed that tax would be due, or taxpayers would opt for disclosure. (The Claimant in this case had not responded to the letters from her bank warning her that there would be a deduction, so she fell in a third category).

39. Ultimately Ouseley J was unconvinced, finding that "Parliament could not sensibly enact provision for the consequence of the receipt of the levied sum without accepting the parts of the Agreement which provide for the levy". That was enough express Parliament authority.

40. He also rejected arguments that the treaty operated in a disproportionate manner and accepted that HMRC acted rationally in formulating a policy for repayment.

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