

TAXATION AND PROTECTION FOR LEGITIMATE EXPECTATIONS

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This note considers how the concept of legitimate expectation may apply in the taxation context.

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Legitimate expectation is shorthand for the public law principles that will, in some circumstances, place limitations on a public authority's ability to act inconsistently with a person's expectation as to how the authority would exercise its powers in a particular situation or case, where the expectation is reasonably based on a representation by, or consistent past practice of, the authority.

Legitimate expectation can sometimes be relied on by a taxpayer to protect his expectation to a particular form of tax treatment, even if the result would afford that taxpayer more favourable tax treatment than that to which he is entitled from a correct application of the relevant tax legislation.

Taxation is, therefore, one context in which the public law principles of legitimate expectation are applied, determining whether a taxpayer has a legitimate expectation, and whether and to what extent HMRC must give effect to it. For a discussion of those principles, see *PLC Public Sector, Practice note, Legitimate expectations* (www.practicallaw.com/6-504-2351).

The purpose of this note is to consider, in the context of taxation, particular examples of how the public law principles have been applied, the mechanisms by which legitimate expectations may arise, and how they may be protected.

LEGITIMATE EXPECTATION IN TAXATION

In considering claims by taxpayers to have a legitimate expectation to a particular form of treatment, the courts have repeatedly taken as their starting point the principles in *R v Inland Revenue Commissioners, ex parte MFK Underwriting Agencies Ltd* [1990] 1 W.L.R. 1545.

Prima facie, taxpayers' only legitimate expectation is that they will be taxed according to statute, and not according to concession or wrong view of the law. The onus is, therefore, upon the taxpayer seeking to rely on a legitimate expectation to justify that claim by pointing to a set of facts that show:

- HMRC conducted itself so as to give rise to a reasonable expectation on the part of the taxpayer that he would be treated in a particular way.

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- Given that legitimate expectation, it would, in all the circumstances, be unfair and an abuse of power for HMRC to act inconsistently with that legitimate expectation.

Legitimate expectation, therefore, involves the application of flexible concepts, such as unfairness and abuse of power, and their application to particular facts is to some extent a matter of judgement and impression. While the judicial application of those concepts in previous tax cases provides a useful guide to the way in which courts will approach legitimate expectation claims:

“the categories of unfairness are not closed, and precedent should act as a guide not a cage. Each case must be judged on its own facts, bearing in mind the Revenue’s unqualified acceptance of a duty to act fairly and in accordance with the highest public standards.”
(R v Inland Revenue Commissioners, ex parte Unilever plc [1996] C.O.D. 421)

Even where a taxpayer is able to establish some form of legitimate expectation to a particular form of tax treatment, it will rarely, if ever, follow that he is entitled to go on indefinitely enjoying an advantage that is in excess of his entitlements under the relevant tax legislation. Rather, the protection afforded to the taxpayer will be limited by both:

- The parameters of the legitimate expectation itself (that is, the parameters of the expectation that it was reasonable for the taxpayer to hold).
- The extent to which HMRC is able to refuse to give effect to that expectation, without thereby acting so unfairly as to be abusing its powers.

For example, where HMRC has given a taxpayer a clear and unambiguous assurance that he would continue to enjoy a particular tax treatment, the courts will generally accept that HMRC should not be permitted to retrospectively deny the taxpayer that tax treatment. However, the courts will generally accept that HMRC is entitled to resile from its previous assurance prospectively after giving the taxpayer reasonable notice. The court may explain that outcome on either or both of two bases:

- That the taxpayer cannot reasonably have expected that its tax treatment would never change.
- That it is not unfair for HMRC to change its position prospectively, after allowing the taxpayer a reasonable transitional period.

Both bases are examples of the courts using the flexibility inherent within the relevant public law principles to protect taxpayers from the conspicuous unfairness of HMRC acting without regard to the reasonable expectations it has previously engendered, while also recognising that it would be inconsistent with good public administration and overall fairness between taxpayers if HMRC could never escape from being bound by non-time-limited assurances unwisely given in the past.

RECONCILING LEGITIMATE EXPECTATION WITH THE SUPREMACY OF LEGISLATION

Legitimate expectation in domestic public law is founded on the common law assumption that Parliament, when passing legislation conferring discretionary powers on public authorities, intends those powers to be exercised in a reasonable manner, within the confines of the principles of good administration that have been recognised and developed by the courts.

Accordingly, domestic public law does not protect legitimate expectations that could be adhered to by the public authority only by contravening the law or acting inconsistently with its legal duties. Therefore, where HMRC is under a precise statutory duty to act in a particular way, HMRC will be required to act in that way notwithstanding any claimed legitimate expectation to the contrary. The position under EU law is different (see [Legitimate expectation and EU law](#) below).

It does not follow, however, that HMRC can refuse to act consistently with a legitimate expectation it has engendered in a taxpayer, simply because to do so would exempt the taxpayer from paying tax that is legally due (that is, due on a precise application of the relevant tax legislation, properly interpreted) or otherwise afford the taxpayer more advantageous treatment than that to which the legislation entitles him.

HMRC is not subject to a statutory duty to collect every penny of tax that is legally due, irrespective of whether doing so would be fair in an individual case, having regard to HMRC’s past statements and conduct. Rather, HMRC has a broad managerial discretion in relation to collecting taxes from those from whom they are due, including a discretion as to whom to pursue and for what amounts.

Further, the efficient collection of taxes is advanced by HMRC providing guidance to taxpayers and acting

consistently with that guidance unless and until it is withdrawn, even if that guidance is subsequently decided by the courts to have been based on a wrong interpretation of the relevant tax legislation (*R (Gaines-Cooper) v HMRC* [2010] EWCA Civ 83 (<http://www.bailii.org/ew/cases/EWCA/Civ/2010/83.html>), at paragraphs 12 to 19 and 59, confirmed by the Supreme Court in *R (Davies and another) v HMRC*; *R (Gaines-Cooper) v HMRC* [2011] UKSC 47, at paragraphs 25 to 27). (For more information on Gaines-Cooper, see [Legal update, Supreme Court dismisses Gaines-Cooper IR20 judicial review appeal \(www.practicallaw.com/4-509-3718\)](#).)

Legitimate expectation principles will, therefore, operate to prevent HMRC from exercising its powers to insist on the collection of tax that is, pursuant to the applicable tax legislation, technically due, in circumstances where, having regard to the legitimate expectation, to do so would be so unfair as to amount to an abuse of power. But domestic public law will not operate to prevent HMRC from resiling (at least with prospective effect) from an agreement that was outside the proper scope of its tax collection powers (for example, see *Al Fayed and others v Advocate General for Scotland* [2004] ScotCS 278, at paragraph 119).

SOURCES OF LEGITIMATE EXPECTATION

MFK Underwriting recognised that legitimate expectations could arise on the basis of HMRC's own formal statements of policy published to the world, since it was reasonable for taxpayers to expect that HMRC would act consistently with those policy statements unless and until they were withdrawn or replaced. In addition, a taxpayer who has requested an individual ruling from HMRC will, provided certain conditions are met (see [Legitimate expectation from an HMRC ruling](#) below), be entitled to expect that HMRC will not resile from that ruling, to the taxpayer's disadvantage, with retrospective effect.

Following *MFK Underwriting*, it was therefore widely assumed that a legitimate expectation could arise only on the basis of an express statement published or otherwise made by HMRC in the realisation that taxpayers, or a particular taxpayer, would rely on it; and that a legitimate expectation could not be based on HMRC's pattern of past practice or conduct. That assumption was shown to be wrong in *Unilever*. The Court of Appeal held that a legitimate expectation could, exceptionally, also be established by HMRC's conduct.

A legitimate expectation that HMRC will act, or refrain from acting, in a particular way will typically be based on one of four sources:

- A ruling (or other assurance or statement of advice) given by HMRC to a particular taxpayer.
- A practice or course of conduct followed by HMRC in its dealings with a particular taxpayer.
- HMRC's published guidance or statement of policy.
- HMRC's practice or course of conduct in its dealings with taxpayers generally or a particular class of taxpayers.

The first and second sources refer to situations in which a particular taxpayer may have a legitimate expectation arising from HMRC's communications, or course of dealings, with that taxpayer. The third and fourth sources refer to situations in which the generality of taxpayers whose situation falls within the scope of the subject matter of the relevant representation or practice, may have a legitimate expectation.

Legitimate expectation from an HMRC ruling

Generally, a taxpayer is entitled to rely on a ruling (or other statement or assurance) given to him by HMRC about a matter affecting his tax liability, provided that both the following conditions are satisfied:

- The taxpayer, when seeking the ruling, **puts all his cards face upwards on the table** by giving HMRC full details of the specific transaction, and making plain that a fully considered ruling is being sought.
- HMRC's ruling is **clear, unambiguous and devoid of relevant qualification**.

In *MFK Underwriting*, Bingham LJ explained, at pages 1569 and 1570, the basis for these conditions:

"The doctrine of legitimate expectation is rooted in fairness. But fairness is not a one-way street. It imports the notion of equitableness, of fair and open dealing, to which the authority is as much entitled as the citizen. The Revenue's discretion, while it exists, is limited. Fairness requires that its exercise should be on a basis of full disclosure. Counsel for the applicants accepted that it would not be reasonable for a representee to rely on an unclear or equivocal representation. Nor, I think, on facts such

as the present, would it be fair to hold the Revenue bound by anything less than a clear, unambiguous and unqualified representation.”

These conditions are, therefore, intended to reflect the principle of fair dealing that is fundamental to legitimate expectation, and are capable of being applied with a degree of flexibility having regard to the factual context. For example, if a well-resourced taxpayer is seeking a ruling on a complex tax saving scheme, it is not unreasonable to expect that taxpayer to provide a high level of detail about the proposed arrangements and, perhaps, even to draw attention to any significant legal issues which the taxpayer’s tax advisers have already identified in relation to the scheme.

In contrast, a sole trader with a relatively small turnover might be held to have provided full details where he has informed HMRC of all the features of the transaction, which he understood to be potentially relevant to the tax treatment, and HMRC responded by providing a ruling without asking for further information or including a relevant caveat.

Provided that a ruling satisfies these conditions, it is generally safe to assume that the ruling will be a source of legitimate expectation for the taxpayer to whom it has been given, since it will be reasonable for the taxpayer to rely on the ruling by expecting HMRC to continue allowing the taxpayer to account for tax in accordance with the ruling (unless and until HMRC withdraws the ruling or otherwise makes it apparent to the taxpayer that the ruling should no longer be relied upon).

However, arguably, there may be an exception for the rare situation where it must have been apparent to the taxpayer that the ruling was wrong or based on a misunderstanding, since in that situation reliance on the ruling may not be reasonable. It may also cease to be reasonable for a taxpayer to rely on a ruling where there has been a significant change in a legal or factual circumstance which is relevant to the matter governed by the ruling, and it should have been apparent to the taxpayer from that change in circumstance that the ruling no longer ought to be relied upon.

It is, normally, only the taxpayer to whom the ruling has been given who can obtain a legitimate expectation on the basis of that ruling. *MFK Underwriting* envisaged, however, that it was possible for a ruling to be relied on by a number of other taxpayers, provided that HMRC was informed, at the time of being asked for the ruling, of the use to which it would be put, and,

in particular, the fact that it would be disseminated to other taxpayers.

R (GSTS Pathology LLP) v HMRC [2013] EWHC 1823 (Admin) is a recent example of claimants successfully demonstrating that they had a legitimate expectation that the VAT treatment confirmed in an HMRC ruling would continue to apply unless and until there was an objective change in circumstances, see [Legal update, Taxpayer had legitimate expectation that VAT ruling would not be revoked without change in objective circumstances \(High Court\) \(www.practicallaw.com/4-533-1385\)](#).

Legitimate expectation from HMRC guidance directed at taxpayers generally

In *MFK Underwriting*, Bingham LJ stated, at page 1569, that:

“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”.

For HMRC to publish guidance setting out its views as to the interpretation and application of tax legislation, explaining to taxpayers and their advisers how particular tax legislation applies to them, is within the scope of HMRC’s tax collecting discretion and furthers the public interest in the efficient collection of taxes. Taxpayers are entitled to expect that HMRC will apply its statements of policy or practice, such as statements and guidance set out in HMRC Notices and Briefs, to situations clearly falling within those statements, unless and until HMRC promulgates new guidance, or otherwise announces a change in practice, applicable for the future (the Court of Appeal in *Gaines-Cooper*, at paragraph 65 and the Supreme Court in *Davies and Gaines-Cooper*, at paragraph 27). The need for the guidance to be clear and unambiguous and for it to be read as a whole was stressed by the Supreme Court in reaching its decision in *Davies and Gaines-Cooper* (see [Legal update, Supreme Court dismisses Gaines-Cooper IR20 judicial review appeal \(www.practicallaw.com/4-509-3718\)](#)). This decision also illustrates that there will be differences of opinion as to whether or not particular guidance satisfies those criteria (see Lord Mance’s dissenting judgment, referred to in that legal update).

It is likely that the courts would apply these principles, not only to guidance on the interpretation and application of tax legislation, but also to extra-statutory concessions (ESCs) published by HMRC. Taxpayers are entitled to expect that HMRC will continue to

recognise and apply ESCs unless and until they are withdrawn with prospective effect. Depending on the circumstances, fairness may also require that HMRC continue to allow taxpayers the benefit of an ESC for a transitional period after the date on which the withdrawal of the ESC has been announced.

It is, however, important to consider both:

- The status of any document that is said to found a legitimate expectation for the taxpayer.
- Any relevant caveats set out in that document.

This is necessary to determine whether that document can be said to constitute guidance or an assurance given by HMRC, on which the taxpayer was entitled to rely, and also the scope and extent of the legitimate expectation (if any). An HMRC Notice or Brief has been prepared specifically for the purpose of providing guidance to taxpayers, and it is, therefore, plainly reasonable for taxpayers to rely on the contents of those publications as setting out the position that HMRC will adopt, subject to any express caveats.

HMRC's manuals

A more difficult, and so far unresolved, question is whether taxpayers are entitled to rely on the contents of HMRC's manuals, which are described by HMRC as containing "guidance which has been prepared for HMRC staff", rather than as guidance for taxpayers, but which have nevertheless been "published for the information of taxpayers and their advisors in accordance with the Code of Practice on Access to Government Information".

The First-tier Tribunal's (tribunal) decision in *Hanover Company Services Ltd v HMRC [2010] UKFTT 256 (TC)*, has been held up by some commentators as authority for the proposition that a taxpayer can never base a legitimate expectation on the contents of an HMRC manual (see [Legal update, Tribunal has jurisdiction to determine legitimate expectation issue in VAT appeal \(www.practicallaw.com/4-502-8006\)](#)). That was a case in which a taxpayer's claim to have a legitimate expectation based on the manual was rejected by the tribunal.

One of the arguments put forward by HMRC was that, having regard to the principles identified in *MFK Underwriting*, HMRC should not be bound by guidance set out in its manual, given that the guidance was intended for HMRC's own officers, and was made available to the public only to comply with principles of transparency and freedom of information.

The tribunal, however, based its rejection of the taxpayer company's appeal primarily on the fact that the company had never itself consulted either HMRC or the manual, but had been guided by the advice of its accountants (paragraph 48), and it is unclear from the decision precisely what findings of fact the tribunal made or whether the accountants based their advice to the company on the HMRC manual.

Nevertheless, the tribunal went on to state, obiter, that the statement in the manual on which the taxpayer sought to rely was subject to the caveats stated at the beginning of the manual, and was, therefore, not capable of giving rise to a legitimate expectation as the representation was qualified.

It is unclear which caveat(s) the tribunal considered to be determinative. It seems likely that the tribunal attached particular significance to the caveat:

"The guidance in these manuals is based on the law as it stood at the date of publication. HMRC will publish amended or supplementary guidance if there is a change in the law or in the Department's interpretation of it."

The tribunal's view that, even if the taxpayer had consulted the manual, the taxpayer could not have founded a legitimate expectation upon it, may therefore be explicable, not because the manual is expressed as being directed (at least primarily) to HMRC officers rather than the public, but because it expressly warns that it is subject to any change of view by HMRC. In any event, it is appropriate to be cautious about placing too much weight on obiter dicta in a single tribunal decision the correctness of which has not yet been considered by a higher court.

Whether a statement made in an HMRC manual is capable, in a particular case, of protecting the taxpayer from a retrospective application by HMRC of an approach which is inconsistent with that statement, is likely to depend, not on a hard-and-fast rule that a legitimate expectation can never be based on the manual, but on a more nuanced analysis that takes account of all the circumstances, including:

- The way that the manual has been relied on by HMRC in its communications both with that taxpayer and with other taxpayers.
- The reason for HMRC's change of view.
- How far back HMRC is seeking to go in assessing underpaid tax.

If, for example, the taxpayer can show that HMRC has been referring taxpayers to what is said in the manual, either as a source of guidance or at least as an indication of HMRC's policy view, it could amount to an abuse of power for HMRC to change its position without prior warning and then apply its new position retrospectively (at least for taxpayers who had organised their affairs by reference to HMRC's previous position as set out in the manual).

Given the caveats in the manual, however, HMRC's position may, arguably, be stronger where its change of view has been brought about by a decision of a court showing that HMRC's previous interpretation of the law set out in the manual was wrong.

Therefore, there remains a high degree of uncertainty as to the approach the courts will adopt in considering legitimate expectation claims based on HMRC's manuals. That approach will no doubt be developed in cases decided in the coming years. In the meantime, a taxpayer who wishes to rely on a statement in a manual should obtain confirmation of HMRC's view in the form of a ruling.

LEGITIMATE EXPECTATION FROM HMRC'S CONDUCT, SILENCE OR ACQUIESCENCE

The decision in *Unilever* (see below) established that a legitimate expectation can be established, not only on the basis of a statement made by HMRC, but also by reference to HMRC's past conduct (see *Sources of legitimate expectation* above). Such a legitimate expectation was found to have arisen on the facts of *Unilever* itself. The Court of Appeal emphasised that HMRC's conduct would be sufficient to establish a legitimate expectation only in an exceptional case, and went on to identify the particular circumstances that were sufficient in that case.

However, the court did not set out a list of factors to be considered in future cases for deciding whether or not a legitimate expectation has arisen. Therefore, it is necessary, in a particular case, to take a holistic view and make a qualitative, and essentially impressionistic, assessment of whether HMRC's departure from its previous pattern of conduct without giving due notice to the taxpayer would be so unfair as to amount to an abuse of power. However, the Supreme Court in *Davies and Gaines-Cooper*, in dealing with the taxpayers' argument that (regardless of the guidance set out in IR20) HMRC's settled practice gave rise to a legitimate expectation that in their circumstances they would be treated as non-resident stated (Lord Wilson):

"For, whereas, in the booklet the Revenue gave unqualified assurances about its treatment of claims to non-residence which, if dishonoured, would readily have fallen for enforcement under the doctrine of legitimate expectation, it is more difficult for the appellants to elevate a practice into an assurance to taxpayers from which it would be abusive for the Revenue to resilite and to which under the doctrine it should therefore be held. "[T]he promise or practice... must constitute a specific undertaking, directed at a particular individual or group, by which the relevant policy's continuance is assured": *R (Bhatt Murphy) v The Independent Assessor* [2008] EWCA Civ 755. The result is that the appellants need evidence that the practice was so unambiguous, so widespread, so well-established and so well-recognised as to carry within it a commitment to a group of taxpayers including themselves of treatment in accordance with it."

It can be inferred from *Unilever* that a legitimate expectation may arise not only from positive actions by HMRC, but also from a consistent pattern of passive acquiescence. *Unilever* was precisely such a case, since the relevant pattern of conduct consisted in HMRC acquiescing in the taxpayer company's late submission of its loss relief claims.

It is, however, very unlikely to be possible to establish a legitimate expectation based on mere silence on the part of HMRC, such as from the fact that HMRC officers have previously made assurance visits to the taxpayer, and have not identified a particular issue or warned the taxpayer of a particular contravention or risk. For example, see *Eurosel Ltd v HMRC* [2010] UKFTT 451(TC), at paragraph 29 and *R (Huntingwood Trading Limited) v HMRC* [2009] EWHC 290 (Admin) (<http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Admin/2009/290.html&query=huntingwood+and+trading&method=boolean>). In *Eurosel* the taxpayer company was unable to found any legitimate expectation based on HMRC's failure to warn the company that its transactions may be connected with MTIC fraud.

The Court of Appeal in *Gaines-Cooper* (at paragraph 65), also made it clear that, although HMRC may have adopted a laissez-faire approach to enforcement in the past, that cannot found a legitimate expectation on the part of taxpayers that HMRC will not subject claims to more rigorous scrutiny in the future. In a system of self-assessment, taxpayers bear the primary responsibility for ensuring that they account for the right amount

of tax and comply with all applicable administrative requirements, and it is the essence of such a system that not all self-assessments will come under scrutiny; only some will be chosen for more intense scrutiny at random.

The responsibility upon taxpayers in relation to self-assessed taxes, along with the observation in *MFK Underwriting* that fairness is not a one-way street, also finds expression in the rejection of claims to legitimate expectation in circumstances where the taxpayer is claiming to have been misled by an error on the part of HMRC, but has himself failed to take reasonable steps to correctly ascertain the legal position (see *Anderson v HMRC* [2010] UKFTT 432 (TC), at paragraphs 20 to 22). In *Anderson*, the tribunal rejected a legitimate expectation claim by a taxpayer to whom HMRC had sent an out-of-date version of a Notice, which therefore stated the wrong time-limit for making claims, because the taxpayer had already received advice from his accountant on that very matter.

LEGITIMATE EXPECTATION AND TAX ADVISERS

In *Hanover* (see *HMRC's manuals* above), the tribunal rejected a company's claim to have a legitimate expectation based on the contents of an HMRC manual, on the ground that the company relied on the advice of its accountants, and did not itself refer to the manual. Some commentators have expressed concern that this may be authority for the proposition that a taxpayer who relies on professional tax advice in ordering his affairs will not be able to rely on any legitimate expectation based on relevant HMRC guidance that was consulted by, or at least within the awareness of, the accountants at the time when they provided their advice.

It is not possible to derive support for such a sweeping proposition from the tribunal's decision, particularly as it is unclear precisely what findings of fact were made about whether the accountants actually based their advice to the company on the HMRC manual. In any event, it is appropriate to be cautious about attaching too much significance to a single decision of the tribunal that appears to be inconsistent with the principles applied by higher courts in considering legitimate expectation claims.

In *Davies and Gaines-Cooper*, the Supreme Court justified holding HMRC to its own guidance by observing that the efficient collection and administration of taxes is assisted by HMRC publishing

guidance and adhering to it. There seems no good reason why that observation should not apply equally to situations where the guidance is read and applied by tax advisers, rather than by taxpayers themselves. Indeed, in some contexts in which HMRC issues guidance (for example, where the affected taxpayers are all large companies who are known to be professionally advised as to their tax affairs), HMRC must be aware that the primary audience for its guidance will be tax advisers, rather than taxpayers themselves.

Therefore, it is thought that a taxpayer should be able to claim a legitimate expectation on the basis of reliance on the advice of tax professionals who were themselves guided by HMRC's guidance at the time when they gave their advice. Taxpayers are, however, required to act reasonably and to exercise an appropriate degree of responsibility in relation to their own tax affairs, and this may in some cases require the taxpayer to query HMRC guidance which appears to be wrong or out of date. In that regard, the degree of responsibility expected of a taxpayer who is professionally advised may be greater than that expected of one who is not (see *Anderson*).

LEGITIMATE EXPECTATION AND HMRC PUBLIC HELPLINES

Given the two conditions identified in *MFK Underwriting* (see *Legitimate expectation in taxation* above), it would be difficult for a taxpayer to establish a legitimate expectation based on a telephone call to HMRC's National Advice Service (NAS). In *Corkteck Ltd v HMRC* [2009] EWHC 785 (Admin) at paragraph 31, Sales J noted that the NAS was held out only as a source of general advice, rather than as a source of binding rulings.

However, he stopped short of holding that a telephone call to the NAS could never provide a basis for a legitimate expectation. Rather, in rejecting the claim of the taxpayer in that case to have a legitimate expectation based on a phone call, he also took account of:

- The short duration of the call.
- The fact that the taxpayer did not provide full disclosure of the relevant underlying facts.
- The fact that the advice obtained in the course of that phone call was inconsistent with HMRC's public guidance, of which the taxpayer was aware.

Therefore, the courts have left open the possibility that a telephone call might be successfully relied upon to found a legitimate expectation, but such a case would

be exceptional. It seems likely that the courts would have greater sympathy for the position of a sole trader or other individual seeking advice about a matter of relatively low value, than a well-resourced trader seeking advice about a matter worth a substantial sum.

In the latter case, it would hardly be reasonable for the taxpayer to rely on an oral statement made over the telephone, rather than seeking independent professional advice and/or a written ruling. Even in a low value matter, however, the evidential hurdle facing the taxpayer is high, since it is the taxpayer who bears the burden of proving the precise terms of the HMRC oral statement on which he relies.

Evidence of those precise terms is unlikely to be available unless the taxpayer kept a detailed contemporaneous note of the call, or HMRC is able to locate a note of the call which is sufficiently detailed to support the taxpayer's allegation. In *Bourne v HMRC [2010] UKFTT 294 (TC)*, the tribunal rejected a claim to a legitimate expectation based on erroneous advice said to have been given over the telephone, by the NAS, to an individual claiming input tax under the DIY builders' scheme. Although the tribunal appeared to accept that a telephone call with HMRC could, in principle, serve as a basis for a legitimate expectation, HMRC had been unable to locate any record of the call, and the tribunal held that the taxpayer was unable to discharge the necessary burden of proof for showing that he had been given misleading advice.

The tribunal noted that there had been several cases before the tribunal in which appellants claimed to have been given misleading telephone advice about the DIY builders' scheme, and repeated the observation made in *Watson v HM Customs & Excise (2004) (VAT 18675)* that HMRC should:

"inform those making enquiries of this type that they should write to ask for written confirmation of the position as discussed in the course of the telephone conversation. Those who are within the VAT system are expected to be aware that such written confirmation is necessary; it is expecting too much of do-it-yourself builders, who are not part of the normal VAT system, to be aware of this without it being specifically pointed out to them by [HMRC]."

HMRC's apparent failure to follow such a practice did not, however, result in the tribunal shifting the burden of proof to HMRC or otherwise mollifying the requirement that the taxpayer prove that he had been misled.

LEGITIMATE EXPECTATION AND CHALLENGES TO LEGISLATION

Legitimate expectation in domestic public law is founded on the common law assumption that Parliament, when passing legislation conferring discretionary powers on public authorities, intends those powers to be exercised within the confines of the principles of good administration. Domestic law legitimate expectation does not constrain Parliament itself, even from passing legislation that may apply retrospectively. Moreover, taxpayers must be taken to understand that, notwithstanding any assurance given by HMRC, tax legislation (both primary legislation and secondary legislation) is subject to change through the normal legislative processes.

The position is different, however, where the relevant taxation legislation is within the scope of EU law (for example, because the tax is VAT or a levy imposed pursuant to EU Directives). Here, the taxpayer is able to rely on the general principles of EU law, which include a principle of protection of legitimate expectations. Since EU law takes precedence over ordinary domestic statutes, the EU principle constrains changes to the tax regime even if mandated by an Act of Parliament, and may, for example, invalidate the change from retroactively affecting tax repayment claims in respect of earlier periods, unless an appropriate transitional period is allowed within which such claims can be made (see *Fleming (trading as Bodycraft) v HMRC [2008] UKHL 2, Legal update, Fleming/Conde Nast: court cannot impose transitional period for three year cap on input VAT recovery (www.practicallaw.com/4-380-4099)* and *Legitimate expectation and EU law* below).

WHEN CAN HMRC RESILE FROM A LEGITIMATE EXPECTATION?

The fact that a taxpayer has a legitimate expectation to a particular tax treatment does not necessarily mean that HMRC is required to adhere to that expectation, and it is very unlikely to mean that the taxpayer may continue to enjoy the benefit of that expectation indefinitely. Rather, HMRC will be required to give effect to the expectation only insofar as a failure to do so would be so unfair as to amount to an abuse of power.

The issue as to whether a particular action of HMRC crosses that threshold of unfairness is a question to be determined by the court itself, applying legal standards, and not for decision by the authority, subject only to review by the court for irrationality (see

Corkteck, at paragraph 26). It is not possible to lay down in advance precise rules for determining whether the threshold has been crossed, since that is an issue to be considered on the facts and circumstances of each case.

In general, however, the courts are ill-disposed towards any departure from the expectation which applies retroactively, and such departures are likely to be justified only if compelling public interest justification can be shown. However, the courts accept that HMRC cannot be bound by a legitimate expectation forever, but must be able to resile from a previous ruling or practice with prospective application. Therefore, once a taxpayer has established that he has a legitimate expectation, the focus of the court's analysis is likely to be on whether HMRC was required to give notice of the change and, if so, what length of notice, or what transitional arrangements, were required in order for HMRC to avoid crossing the threshold of unfairness.

The method of communicating a change may also be a factor. In *Cameron & others v HMRC [2012] EWHC 1174 (Admin)*, where HMRC had published a leaflet, booklet or equivalent aimed at a particular group of taxpayers and had given no notice of its withdrawal, communication by HMRC to agents known to act for taxpayers in that sector, or publication in a relevant trade or sector journal, was considered by the High Court to be insufficient to alert all affected taxpayers to the fact that the published guidance was no longer relevant (see [Legal update, HMRC bound by published concessions until publicly withdrawn \(www.practicallaw.com/8-519-5084\)](#)).

In recent years, courts have tended to describe their approach to enforcing legitimate expectations, not only in terms of a threshold of unfairness, but also in terms of:

“weighing the requirements of fairness against any overriding interest relied upon for the change of policy” (*R v North East Devon Health Authority, ex parte Coughlan [1999] EWCA Civ 1871*, cited in *Corkteck*, at paragraph 26).

It is suggested that the more modern formulation better reflects the potential breadth of the considerations that the court may take into account, and the nature of the analysis being undertaken by the court, which involves deciding where the balance should lie between, on the one hand, the individual taxpayer's right to be treated in accordance with his legitimate expectation, and on the other hand, the public interest.

However, the formulation might also imply a more favourable approach to taxpayers who have succeeded in establishing a legitimate expectation, since it suggests that, once the legitimate expectation has been established, the burden shifts to the public authority to justify any refusal to give effect to that legitimate expectation. Such an approach appears more favourable to the taxpayer than one which requires the taxpayer to show that HMRC's failure to give effect to the expectation is (in the test endorsed in *Unilever*) “so outrageously unfair that it should not be allowed to stand”.

In *GSTS Pathology*, the High Court granted an interim injunction preventing HMRC implementing its decision to require the claimants to adopt different VAT treatment from that contained in an HMRC ruling pending a determination by the tax tribunal of the proper interpretation of the law underlying that VAT ruling. The High Court, which granted the interim injunction on the merits, carefully weighed a large number of competing factors (see [Legal update, Taxpayer had legitimate expectation that VAT ruling would not be revoked without change in objective circumstances \(High Court\) \(www.practicallaw.com/4-533-1385\)](#)).

HMRC MISDIRECTION AND LEGITIMATE EXPECTATION

Legitimate expectation, as applied in the taxation context, often overlapped as a potential source of rights for the taxpayer, with HMRC's ESC 3.5: Misdirection. ESC 3.5 sets out circumstances in which HMRC would protect a taxpayer against suffering a detriment as a result of his having been misdirected by HMRC. That ESC was, like other ESCs, itself enforceable on the basis of legitimate expectation.

A taxpayer who believed himself to have been misdirected by HMRC therefore had the option of bringing a judicial review claim for breach of legitimate expectations arising from both:

- The misdirection itself, insofar as it constituted a statement or assurance given by HMRC on which the taxpayer was entitled to rely.
- The statements made within ESC 3.5 as to the circumstances in which HMRC would refrain from enforcing tax liabilities that would otherwise be due.

ESC 3.5 was withdrawn by HMRC with effect from 1 April 2009, but may still be relevant to situations in which the misdirection was given prior to that date.

REMEDIES AND JURISDICTION

A taxpayer who claims that a decision of HMRC unlawfully fails to give effect to a legitimate expectation of his may seek relief from the Administrative Court on a claim for judicial review, asking that the decision be quashed.

Such a claim (that is, a claim by the taxpayer that he should not be treated in accordance with the position obtaining under a correct application of the tax legislation, because for HMRC to insist on applying that position to the taxpayer would, in all the circumstances, constitute an abuse of power by HMRC, having regard to the taxpayer's legitimate expectation engendered by HMRC) cannot instead be brought in the First-tier Tribunal (see *Aspin v Estill (Inspector of Taxes) [1987] STC 723* and *Customs and Excise Commissioners v National Westminster Bank plc [2003] EWHC 1822 (Ch)*). Thus, a taxpayer who wishes to challenge a tax liability assessment on the ground that it was based on an erroneous interpretation of the tax legislation, but also, in the alternative, on the ground that the making of the assessment was inconsistent with a legitimate expectation arising from HMRC's published guidance and therefore an exercise of HMRC's enforcement discretion in a manner amounting to an abuse of power, would have to both:

- Appeal against the assessment to the First-tier Tribunal.
- Issue separate proceedings in the Administrative Court under CPR Part 54 (judicial review) raising the legitimate expectation ground, and asking that the judicial review proceedings be stayed pending the determination of the appeal to the tribunal.

That way, if the appeal to the tribunal is ultimately unsuccessful, the taxpayer will be able to pursue the legitimate expectation ground in the Administrative Court without falling foul of the three-month time limit for bringing a judicial review claim to challenge the assessment decision.

The need to bring two sets of proceedings in such circumstances gives rise to additional costs and inconvenience for taxpayers. The judicial review procedure might also be regarded as relatively disadvantageous for taxpayers wishing to pursue legitimate expectation claims involving disputes of fact, since the judicial review procedure is almost always "paper-based"; it is rare (though possible) for the Administrative Court to allow oral examination of witnesses and cross examination.

In *Oxfam v HMRC [2009] EWHC 3078 (Ch)* (see [Legal update, High Court confirms HMRC not bound by apportionment agreement \(www.practicallaw.com/8-500-8902\)](#)), Sales J expressed the view that the First-tier Tribunal's statutory jurisdiction to decide on, for example, the amount of tax that is properly due, or the lawfulness of an assessment that is the subject matter of the appeal, was sufficiently broad to enable the tribunal to consider public law arguments, including legitimate expectation. Sales J's reasoning was, essentially, that the lawfulness of HMRC's decision to accept that the taxpayer's liability was that which accorded with the alleged legitimate expectation was a collateral issue to be decided by the tribunal as part of exercising its statutory jurisdiction to decide on the appellant's tax liabilities.

Sales J's views must now, however, be read subject to the Upper Tribunal's subsequent decision in *HMRC v Noor [2013] UKUT 071 (TCC)* (<http://www.bailii.org/uk/cases/UKUT/TCC/2013/71.html>) (see [Legal update, First-tier Tribunal has no jurisdiction to determine legitimate expectation issue in VAT appeal \(Upper Tribunal\) \(www.practicallaw.com/1-524-3267\)](#)), ruling that the First-tier Tribunal had erred in considering itself to have jurisdiction to uphold a taxpayer's appeal against HMRC's rejection of his input tax repayment claim on the basis of legitimate expectation. The taxpayer had claimed to have relied on misleading advice by HMRC as affording him an entitlement to the input tax notwithstanding that he did not satisfy the conditions for claiming such repayment under the ordinary application of the VAT legislation (see [Legal update, Tribunal confirms jurisdiction to determine legitimate expectation issue in VAT appeal \(www.practicallaw.com/2-506-5009\)](#)).

Following the Upper Tribunal's decision in *Noor*, it seems very doubtful that the views expressed by Sales J in *Oxfam* can properly be relied on by taxpayers for contending for a broad interpretation of the tribunal's jurisdiction so as to enable it to hear arguments based on legitimate expectation. For example, see the discussion of those cases in *Gore v HMRC [2014] UKFTT 904 (TC)* (<http://www.bailii.org/uk/cases/UKFTT/TC/2014/TC04019.html>) where the tribunal drew a distinction between the following types of situation:

- Those where the tribunal has to review the lawfulness of an exercise of discretion by HMRC in order to determine the amount of tax properly due under the tax legislation (for example, a case where what is challenged is the reasonableness of HMRC's "best judgment" as to the amount of tax that is properly due.
- Those where HMRC's position on the taxpayer's liability is correct as a matter of application of the

tax legislation but where the taxpayer is relying on public law arguments that HMRC's insistence on adhering to that position is an unreasonable or otherwise unlawful exercise of its enforcement discretion.

The tribunal's statutory jurisdiction embraced the former category of situations, but not the latter category (within which category legitimate expectation arguments will generally fall).

LEGITIMATE EXPECTATION AND EU LAW

EU law recognises a principle of protection of legitimate expectations. The principle affords a measure of protection for:

"any individual who is in a situation in which it appears that the administration's conduct has led him to entertain reasonable expectations"
(*Mavridis v Parliament* (C-289/91), at paragraph 21).

The principle applies to the actions and decisions of HMRC and, indeed, the UK generally, including Parliament, wherever it is taking a decision or otherwise acting within the scope of EU law, including when legislating in relation to taxes, such as VAT, which are imposed pursuant to EU Directives. The member state's

actions must be compatible with individual taxpayers' rights arising from that principle.

As to what the EU principle will require in practice, there is a great deal of similarity between that principle and the domestic law principle of legitimate expectation. The *Court of Justice* (www.practicallaw.com/5-107-6553) has recognised, for example, that taxpayers must be taken to understand that the law may be changed (*Gemeente Leusden v Staatssecretaris van Financien* (C-487/01)), but such changes can normally apply only with prospective effect, save perhaps to stop an abuse of rights (*Grundstückgemeinschaft Schloßstraße GbR v Finanzamt Paderborn* (C-396/98)).

One significant difference from the domestic law principle is that the EU principle is capable of protecting a legitimate expectation to a particular treatment even where, for the public authority to apply that treatment, it would be acting directly contrary to a duty imposed on it by legislation. EU law does not regard the fact that fulfilling the assurance would be unlawful as necessarily decisive against giving effect to the expectation, but weighs that strong interest in legality against the principle that legitimate expectations merit protection, so as to decide which principle outweighs the other in the circumstances of the case (*Belgium v Societe Cooperative Belovo* (C-187/91), *Advocate General Gulmann's opinion*, at paragraph 19).

R V INLAND REVENUE COMMISSIONERS, EX PARTE UNILEVER PLC [1996] STC 681

For over 20 years the taxpayer company had submitted its loss relief claims after the expiry of the statutory deadline, but the Inland Revenue (now HMRC) had nevertheless accepted the claims. This allowed the company to set off the losses against its current year profits at the time when the claim was made. The Inland Revenue practice of accepting the claims came to a sudden end when it decided to refuse loss relief claims which the company had made, on the ground that they had been made out of time.

The company sought judicial review of the Inland Revenue's decision to refuse the claims, contending that, having regard to its conduct in the past, it could not in fairness treat the claims as time-barred, but rather, was required to exercise in the company's favour a discretion to accept the claims out of time. The Court of Appeal agreed. While there had been no clear unambiguous and unqualified representation by the Inland Revenue that it would accept the company's late-submitted claims, a consideration of the circumstances led cumulatively to the conclusion that the rejection of the claims based on the time limit, without clear advance notice, was so unfair as to amount to an abuse of power. In particular, the court noted that the procedure adopted by the Inland Revenue and the company for claiming loss relief had operated harmoniously for years, enabling the company to claim relief for no more than the losses it had actually incurred. If the Inland Revenue were permitted to refuse the claims, it would receive a windfall as a result of the understandable error of an honest and compliant taxpayer, shared over many years by the Inland Revenue, and the taxpayer would be seriously prejudiced by the fact that the Inland Revenue had raised the time-bar objection now and not before.