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## REVENUE GUIDANCE COMES WITH 'HEALTH WARNINGS'

### Introduction

It is probably something of an understatement to say that tax law is seldom simple to understand. What better way to seek clarification of a tax issue than to check how HM Revenue & Customs (HMRC) believes a particular piece of legislation should be interpreted? The guidance provided by HMRC may subsequently be discovered to be incorrect. This may come as quite a shock to a taxpayer who subsequently faces a bill for underpaid tax. Whether or not such a tax bill would be set aside by the courts is just one of the practical issues concerning the reliance on HMRC guidance that we have attempted to illustrate in this document.

### Legitimate expectation

In the recent case of Hanover Company Services Limited -v- HMRC (2010), a company appealed against an assessment for VAT on the basis that the guidance provided by HMRC had changed and therefore, the appellant company should not be liable for the VAT due in respect of the period before HMRC changed its guidance. It was argued on behalf of the claimant company, Hanover, that the company had a legitimate expectation that HMRC would apply the VAT law in accordance with the guidance provided by HMRC at that time and therefore, that HMRC were 'stopped' from raising the assessment. The Tribunal found that for Hanover to succeed in its legitimate expectation claim, it was necessary to show that by deciding to make the assessment there had been unfairness amounting to an abuse of power, or irrationality on the part of HMRC.

Unfortunately for Hanover, it was the company's accountants that had relied upon the HMRC guidance and not the company itself. The Tribunal, therefore, found that it could not be considered outrageously unfair for HMRC to have raised the assessment even though the assessment was not consistent with the earlier guidance.

Furthermore, the Tribunal also referred to the case of R -v- Inland Revenue Commissioners, ex parte MFK Underwriting Agencies Ltd and Others (1989), where it was found that for a legitimate expectation claim to succeed 'it is necessary that the ruling or statement relied upon should be clear, unambiguous and devoid of relevant qualification'. The earlier guidance provided by HMRC was qualified and therefore, the Tribunal found that even if Hanover had relied on the HMRC guidance, the fact that it came with a 'health warning' meant that the guidance was not capable of giving rise to a legitimate expectation.

## HMRC manuals

There are numerous manuals prepared by HMRC that cover most areas of taxation. Users of these manuals should be aware that they are all qualified by the following text that was highlighted in the Hanover case:

- These manuals contain guidance which has been prepared for HMRC staff. It is being published for the information of taxpayers and their advisors in accordance with the Code of Practice on Access to Government Information.
- It should not be assumed that the guidance is comprehensive or that it will provide a definitive answer in every case.
- The guidance in these manuals is based on the law as it stood at 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. HMRC may give earlier notice of such changes through Tax Bulletin or a press release.

The ramifications of the final paragraph above should be given special consideration. There can be a significant delay between HMRC deciding that there has been a change of law, or in their interpretation of it and the respective manual being updated. Whilst the change would have been notified through Tax Bulletin or a press release, such notifications are generally more difficult to locate than the relevant section of a manual. Taxpayers may be relying on out-of-date guidance in a manual that could lead to the underpayment or overpayment of tax.

Examples of out-of-date guidance contained in HMRC manuals can be found in respect to furnished holiday lettings and also with the definition of a dwelling house for capital allowances.

In a Technical Note dated 22 April 2009, HMRC stated that the furnished holiday letting regime, with its significantly more beneficial tax treatment as compared to a property business, would be extended to properties situated within European Economic Area (EEA) countries. At the date that this document was produced, the Property Income Manual (at PIM4105 and PIM4703) as well as the Capital Allowances Manual (at CA20025), still state that furnished holiday letting treatment is only available for properties situated within the UK.

On 29 December 2008, HMRC issued Revenue & Customs Brief 66/08 that set out revised guidance on the definition of a dwelling house for capital allowances. This guidance stated that HMRC had revised their approach to the application of CAA 2001, Section 35 to the extent that the non-communal areas of university halls of residence and similar multi-occupation properties are to be treated as dwellings and therefore, capital allowances denied for the plant and machinery within such areas. The Brief also introduced the possibility of making claims for common areas (such as communal kitchens and lounges) of houses in multiple occupation, which had previously not existed. Again, the capital allowances manual has not been updated and HMRC will be revising the guidance again in a further Brief to be issued in October of this year. In the meantime, taxpayers that are relying solely on the current guidance set out in the manual, will be unaware that a window of opportunity currently exists that will close when the new guidance is issued.

## Non-statutory clearance

Under Code of Practice 10 (COP 10) HMRC will provide written confirmation of how it will apply tax law with regard to a specific transaction or event. This is referred to as non-statutory clearance because it relates to situations where HMRC are not required by statute law to provide clearance. Such clearance will be provided by HMRC in respect of all business taxes where there is material uncertainty. Clearance is available either before or after the relevant transaction but, in the case of pre-transaction clearance, evidence must be supplied that the transaction is genuinely contemplated.

A non-statutory clearance will only be relevant to the taxpayer applying for the clearance and the specific transaction for which the clearance was requested. If the clearance was requested by the taxpayer's agent, the agent cannot apply the clearance to the same tax issue involving other taxpayers. HMRC will generally be bound by such a clearance unless the interpretation of the law changes due to new case law or retrospective legislation, or the nature of the transaction changes, or the taxpayer did not disclose all the relevant information.

If HMRC provides a clearance that is incorrect in law, they will be bound by their advice provided that it is clear, unequivocal and the taxpayer can demonstrate that:

- the advice was relied upon;
- the taxpayer had made full disclosure of all relevant facts;
- the application of the law would result in the taxpayer's loss.

The principles of legitimate expectation also apply in the case of a non-statutory clearance. Where HMRC are bound by the clearance and they subsequently inform the taxpayer that the clearance is incorrect, the taxpayer will only be required to start accounting for tax on the correct basis from the date of notification.

## Penalties

In the Hanover case, the taxpayer company incurred a penalty even though it relied on the advice of its accountants. The penalty was enforced by the Tribunal because Hanover did not have a 'reasonable excuse' under VAT Act 1994, Section 63. That legislation has now been superseded by Finance Act 2007, Schedule 24, for returns that need to have been submitted by 1 April 2009.

In accordance with Finance Act 2007, Schedule 24, the taxpayer will be liable for an inaccuracy within a return if he has not exercised reasonable care to avoid the inaccuracy. This requirement to take reasonable care extends to ensuring, as far as the taxpayer is able, that the information provided by others is accurate. If the taxpayer does not exercise reasonable care, then he will be deemed to have been careless and a penalty for the inaccuracy is likely to result. It is debatable whether Hanover would be viewed as having been careless under the new penalty regime of Finance Act 2007, Schedule 24, as Hanover certainly appears to have taken reasonable steps to ensure the correct VAT treatment of the supplies, even though it did not directly consult HMRC guidance.

Both case law and statute law support the argument that a penalty would not usually be incurred in respect of any inaccuracy within a return when the taxpayer has relied upon HMRC guidance, even if that guidance is qualified and proves to be inaccurate. It is not as certain as to whether a penalty could arise if the taxpayer's agent, rather than the taxpayer, relied on HMRC guidance, but provided the taxpayer can prove reasonable care, then the taxpayer should be able to rely on the advice of the agent.

## Conclusions and recommendations

If a taxpayer has underpaid tax due to reliance on HMRC guidance, then the taxpayer may be protected from a later assessment for the tax provided that the taxpayer can substantiate a claim to legitimate expectation. In order to establish legitimate expectation, the taxpayer needs to show that the HMRC guidance was directly relied upon (not just relied upon by the taxpayer's accountant) and the guidance must not be qualified.

We have seen above that the HMRC manuals contain a 'health warning', thereby making legitimate expectation difficult to establish. Furthermore, as demonstrated by the Hanover case, the taxpayer must show direct reliance on the guidance. This is always likely to be difficult when the taxpayer relies heavily on an agent for tax advice. Perhaps one solution would be for the agent to draw to the attention of the taxpayer any HMRC guidance relied upon in the tax return. This would not only enable the taxpayer to substantiate direct reliance on the guidance, but should also help to prove reasonable care. Even if the legitimate expectation claim failed, then at least the taxpayer should not also suffer a penalty on the underpaid tax.

Another solution, where there is material uncertainty concerning the tax issue involved, is for the taxpayer to seek a non-statutory clearance under COP 10. Provided there is full disclosure of the facts and no changes to the nature of the transaction or to the law (either by case law or retrospective legislation), HMRC will generally be bound by such clearance.

Finally, it should be noted that the guidance in the manuals could also lead to an overpayment of tax. This could apply in the case of furnished holiday lettings, where the guidance has not been updated in respect to properties within EEA countries. The manual guidance may also be subject to subsequent revisions that create both opportunities and complications, as in the case of the definition of a dwelling house for capital allowances. It is, therefore, important that the taxpayer does not just rely on the manuals, but is also aware of other HMRC publications and ongoing consultations that could have a bearing on the correct interpretation of tax law.

For further advice concerning any of the issues raised in this briefing, please contact one of our key individuals detailed overpage, or alternatively call our helpline on 0800 526262. Information on other property tax related topics can also be found on our website at <http://bankingtaxfinance.davislangdon.com>.