The Personal Tax Planning Review

ARE ADVANCE RULINGS BINDING ON THE REVENUE

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Taxpayers and their agents frequently wish to obtain advice from their Inspector of Taxes. The purpose of this article is to examine to what extent the Inland Revenue is bound by that advice. The problem has recently been considered by the Courts in the case of *R v Commissioners of Inland Revenue, ex parte Matrix Securities Ltd*. The points at issue were whether an agreement can be withdrawn, from what date and with what consequences, also whether the incompetence of the Inspector is a let-out.

The Revenue are to be applauded for the practice set out on 18th October 1990 (see ICAEW TR 818) whereby Inspectors of Taxes "...will of course continue where practicable to inform practitioners about the Revenue's interpretation of tax law as it applies to any case which falls within the responsibility of that office".

At present the only method of appealing against an advance ruling (or its withdrawal or doubt whether it had been made) is by Judicial Review. This has to demonstrate that there has been an abuse of power by the Revenue (as was unsuccessfully claimed in the *Preston* case) or that the conditions for openness had not been complied with.

These conditions were laid down by Bingham LJ in *R v CIR ex parte MFK Underwriting Agencies Ltd* [1990] 1 WLR 1545 at page 1569:

> " First it is necessary that the taxpayer should have put all his cards face up on the table. This means that he must give full details of the specific transaction on which he seeks the Revenue's ruling... It means he must indicate to the Revenue the ruling sought. It is one thing to ask an official of the Revenue whether he shares the taxpayer's view of a legislative provision, quite another to ask whether the Revenue will forgo any claim to tax on any other basis. It means that the taxpayer must make plain that a fully considered ruling is sought ....and the use he intends to make of

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> any ruling given.......this is because knowledge that a ruling is to be publicised in a large and important market could affect the person by whom and the level at which a problem is considered and, indeed, whether it is appropriate to give a ruling at all. Secondly, it is necessary that the ruling or statement relied on should be clear, unambiguous and devoid of relevant qualification."

The general test for unreasonableness was laid down in the *Wednesbury* case. *(Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1947] 2 AlER 680)*. The dictum of Lord Greene MR is frequently quoted:

> "...the principle, which seems to me to be that the court is entitled to investigate the action of the local authority with a view to seeing whether it has taken into account matters which it ought not to have taken into account, or conversely, has refused to take into account or neglected to take into account matters which it ought to take into account. Once that question is answered in favour of the local authority, it may still be possible to say that the local authority, nevertheless, has come to a conclusion so unreasonable that no reasonable authority could have ever come to it. In such a case the court can interfere."

In the UK, unlike many other countries, for example Canada, Australia, New Zealand and to a lesser extent the United States, there is no general advance rulings procedure. The 1993 Institute for Fiscal Studies Conference at Oxford discussed the merits and de-merits of such a scheme based on papers by Professor John Prebble of Wellington University and by the London Chamber of Commerce. In summary, the advantages are certainty for both sides and an integral part of a workable self-assessment system; the disadvantages are alerting the Revenue, being locked into a particular scheme and making the scheme public knowledge. It was also debated whether rulings should be published or open to appeal.

There are a number of specific advance rulings procedures called Clearances. Clearances can be obtained for transactions in securities (s.707 ICTA 1988). The decision is one for the Board and there is no right of appeal against a refusal to give a clearance. Section 707(2) can void a clearance if:

> "If the particulars...are not such as to make full and accurate disclosure of all facts and considerations relating thereto which are material to be known to the Board, any notification given by the Board ...shall be void."

The *Matrix* case concerned a unit trust tax avoidance scheme whereby a building in an Enterprise Zone was alleged to be bought for £95 million yet the vendor only received £8 million. The investors would pay £31 million and borrow £64 million from a bank. However this £64 million was a circular self-cancelling payment The pretence of this tax avoidance scheme was that the investors were expending that £64 million. If the scheme were successful the capital allowances and thus the value of the tax relief would be based on the figure of £95 million. Initial Allowances under s.10A Capital Allowances Act 1990 are based on the net price paid by the purchaser for the relevant interest. The trick of circular self-cancelling payments had been rejected in *Ensign Tankers (Leasing) v Stokes* [1992] 1 AC 655. Thus looking at the tax avoidance scheme as a whole, the claim to initial allowances based on the pretended expenditure of £95 million had to fail.

The case turned on the following:

1. Had the clearance application fully disclosed all the material facts, i.e., had they come with clean hands?

2. Should the application have been made to the local Inspector or to Financial Institutions Division?

3. Was the competence of the Inspector relevant?

4. Was it an abuse of power to withdraw the clearance once given?

The House of Lords unanimously held that there had been no abuse of power by the Revenue and that the Revenue were entitled to revoke the clearance for this tax avoidance scheme.

The scheme promised substantial return at no risk. For a £1,000 share, an investor would pay only £325 (the balance being meet by the self-cancelling loan), yet immediately receive a repayment of £392 (being the value of the initial allowance for a 40% taxpayer). The purveyors of the scheme sought a non-statutory clearance from their local Inspector of Taxes in a five page letter of 15th July 1993. The Inspector gave, on 27th July 1993, an unqualified clearance, despite, as his affidavit shows, not having read most of the application nor submitting it to his Head Office specialist. The clearance application referred to the purchase price of £95 million, but did not make it clear that the vendor would in the end only receive £8 million. The latter fact could have been found by digging and further enquiry.

A revised scheme was submitted to the same Inspector on 9th September requesting clearance by return of post. This he did. The advertising leaflet for investors which very clearly spelled out that it was a tax avoidance scheme with substantial returns but at no risk to the investor, was not sent to the Inspector with the initial clearance application of 15th July. It was included with the second clearance application of 9th September, being described as an Information Memorandum (8th Draft) running to some 36 pages. Whilst the taxpayer's claim that no draft of this memorandum existed at the time of the submission of 15th July is undoubtedly true, we find it difficult to believe that they were unaware of the unique selling point of their scheme. In fact a later affidavit did disclose the existence of a "skeleton" prospectus. This was not sent to the Inspector on the grounds of "cost".

The purveyors of the scheme did not submit their application for clearance to Financial Institutions Division (the Inland Revenue's Head Office Specialists). The purveyors of the scheme were aware from a circular about similar schemes issued by Financial Institutions Division on 6th May 1993 that they would have been most unlikely to have been given a clearance by Financial Institutions Division. In the House of Lords, Lord Jauncey still thought it appropriate to submit the application to the local Inspector, rather than Financial Institutions Division. This view was not shared by Lord Browne-Wilkinson as the Revenue had made it known that a clearance could only be obtained at a particular level and to withdraw a clearance made at the wrong level was not an abuse of power.

In their letter of 23rd September 1993, the purveyors of the scheme knew that the Inspector should not have given clearance and were relying on the decision in *MFK* to go ahead. (The *MFK* case established that if a taxpayer had made a full disclosure of the relevant circumstances, the Revenue would be acting unfairly if they withdrew the clearance. However, in the *MFK* case, the Revenue had not given a clearance but had only made general and qualified statements.) If Policy Division overruled the local Inspector, they argued that they would be able to sue the Revenue. They went as far as suggesting that *MFK* created estoppel against the Crown. This was rejected by the High Court.

In the Court of Appeal, Dillon LJ made much of the incompetence of the unfortunate Inspector, almost to the point that had he not been inept the Revenue would have been bound by his decision. The House of Lords did not take this view. Lord Griffiths cast doubt on the *MFK* case, maintaining that a mistaken clearance once given could still be withdrawn at a later date even if the application was wholly clean. He went on to suggest that, in fairness, money spent on promoting the scheme in reliance on the clearance should be reimbursed by the Revenue.

This view is similar to that stated by Customs & Excise on Misdirection in Notice 748 on Extra-Statutory Concessions. This reads:

> "If a Customs officer, with the full facts before him, has given a clear and unequivocal ruling on VAT in writing or, knowing the full facts, has misled a registered person to his detriment, any assessment of VAT due will be based on the correct ruling from the date the error was brought to the registered person's attention."

If the Inland Revenue had adopted a similar published approach, the *Matrix* case may well have been unnecessary. Lord Templeman took an even stronger view, describing the case before him as a "tax avoidance scheme designed to plunder the

Treasury of £38 million", hence there was no doubt that the Revenue were right to withdraw the clearance.

The two recent *Matrix* cases (*Matrix Securities* the subject of this article and the *Matrix Churchill* prosecution case, the subject of the Scott enquiry) make a fascinating pair to compare and contrast. In both cases a trader applied for a clearance. In one, the government went to extraordinary lengths to pretend they had never given a clearance. In the other, a clearance once given was withdrawn partly on the grounds that the giver was incompetent and unauthorised to give it. We leave it to the reader to decide who were the innocent parties. The lessons to be learnt from the Matrix case are:

1 The application must be clean, disclose all material facts and draw attention to relevant legislation and cases (favourable or not). Half-truths are not acceptable.

2 The application must be made at the right level and without undue pressure being brought to bear.

3 The applicant must not be on notice that the Inspector is unlikely to have the authority to give such a clearance.

4 Once it comes to the attention of the applicant that the clearance has been wrongly given, he should invite the Revenue to reconsider their position.

This is similar to receiving a repayment for ten times the correct figure from the Revenue; most people feel there is an obligation to advise the Revenue . A similar viewpoint can be obtained from the philosophy behind s.14(1)(b) FA 1985 dealing with penalties for serious misdeclaration for VAT. A penalty is triggered where "an assessment is made which understates a person's liability to tax and", within 30 days, "he has not taken all such steps as are reasonable to draw the understatement to the attention of the Commissioners".