[2016] UKUT 0173 (TCC)

Case number UTJR/2015/003

JUDICIAL REVIEW – determining place of effective use and enjoyment of telecommunications services - whether methodology for apportioning charge between EU and non-EU services based on usage is unlawful – whether claimants had legitimate expectation derived from correspondence with HMRC that claimants could continue to use methodology based on revenues until change in law or claimant's business – whether HMRC had duty to consult claimants before requiring them to apply a new methodology – whether HMRC consulted claimants adequately

IN THE UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

IN THE MATTER OF AN APPLICATION FOR JUDICIAL REVIEW BETWEEN

THE QUEEN
on the application of
TELEFONICA EUROPE PLC (1)
TELEFONICA UK LIMITED (2)

Claimants

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Defendants

Tribunal: The Hon Mrs Justice Rose DBE
Judge Greg Sinfield

Sitting in public at the Royal Courts of Justice, The Rolls Building, Fetter Lane, London EC4 between 18 and 20 January 2016

Sam Grodzinski QC, counsel, instructed by Herbert Smith Freehills LLP, solicitors, for the Appellants

Jessica Simor QC and Eleni Mitrophanous, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Paragraph 8 of Schedule 4A to the VAT Act 1994 ('VATA94') provides that where a supply of telecommunications services would otherwise be regarded as made in the UK but the services are "effectively used and enjoyed" in a non-EU country then the supply is treated as made in the non-EU country and thus not chargeable to UK VAT. The Claimants (together, 'Telefonica') challenge a decision of the Defendants ('HMRC') issued on 26 November 2014 ('the Decision') that Telefonica must change the way it calculated the proportion of the monthly charge to customers for the supply of access to the mobile telephone network ('the network access charge', sometimes also referred to as 'line rental') that related to such access used and enjoyed by customers outside the EU ('the non-EU access').

2. Between 2008 and 2014, Telefonica, with the agreement of HMRC, calculated the value of the non-EU access by reference to the charges made for voice calls, messaging and data services not included in the customers' fixed monthly charge ('additional services'). In summary, Telefonica first determined what proportion of the charges paid by the customer for additional services in a month related to additional services used in non-EU countries as compared with total charges paid by that customer in that month for the time spent and number of texts sent, since charges for additional services are calculated on the basis of time spent and texts used. Telefonica then applied that proportion to the network access charge and treated the amount so determined as not subject to VAT. Telefonica referred to that method of calculation as the 'Revenue Methodology'. In November 2014, HMRC formed the view that the Revenue Methodology was distortive because customers on the relevant tariffs pay more for non-EU additional services than for additional services in the UK and EU. This difference in the tariff for EU and non-EU additional services meant that the charges for non-EU additional services were a much higher proportion of total cost of additional services than the volume of non-EU additional services compared with the overall volume of additional services. HMRC stated that Telefonica should calculate the proportion of the monthly network access charge that relates to non-EU access by reference to actual usage of the supply such as time spent on calls, numbers of texts and volumes of data used by customers outside the EU as a proportion of the total use of such services. This method of calculating the amount of the monthly network access charge that relates to the non-EU access is referred to as the 'Usage Methodology'. The Usage Methodology would result in a significantly smaller proportion of the monthly network access charge being treated as relating to services used and enjoyed outside the EU and therefore not subject to VAT.

3. Telefonica challenges the Decision, by way of judicial review, on three grounds, namely that:

> (1) the Usage Methodology that HMRC required Telefonica to use is unlawful because it is contrary to EU and domestic VAT legislation;
>
> (2) the Decision constituted a breach of Telefonica's substantive legitimate expectation, based on a clear assurance given by HMRC in 2008, that it

could continue using the Revenue Methodology until there was a material change in the law or in Telefonica's business, which there has not been; and

(3) it was taken without adequate consultation to enable Telefonica to explain to HMRC the fundamental difficulties inherent in the adoption of the Usage Methodology which was a breach of Telefonica's procedural legitimate expectation.

4. Telefonica's claim was commenced in the Administrative Court in February 2015. Nugee J granted permission on the papers on 11 May 2015 on the second and third grounds described above but refused permission in relation to the first ground. There was then a hearing before Ouseley J on 23 July at which permission was also granted for Telefonica to argue the first ground. Recognising the specialist nature of the issues, Ouseley J transferred the judicial review proceedings to the Upper Tribunal, pursuant to section 31A Supreme Court Act 1981 (as inserted by section 19 of the Tribunals, Courts and Enforcement Act 2007).

5. In contesting the grant of permission, HMRC argued, amongst other things that some of the judicial review grounds raised issues of fact which should be dealt with by Telefonica appealing to the First-tier Tribunal (Tax Chamber) ('the FTT') against any future VAT assessment calculated by HMRC on the basis of the Usage Methodology. HMRC accepted that the two legitimate expectation grounds could not be resolved by the FTT and could only be considered by way of judicial review. As regards the first ground, however, Telefonica contended that since the ground alleged that the Usage Methodology was unlawful and not merely inappropriate, it raised narrow issues of statutory construction and required no factual investigation. It was therefore convenient they argued to consider that at the same time as the second and third grounds were considered. There had initially been two other grounds of challenge included in Telefonica's application for permission, but after Nugee J refused permission for those on the papers, Telefonica accepted that those were matters that should be dealt with by the FTT, if and when Telefonica appealed against a VAT assessment.

6. In his order dated 24 July 2015, Ouseley J

(1) granted permission to appeal on ground 1;

(2) transferred the claim to the Upper Tribunal; and

(3) directed that in the event that ground 1 does not succeed, the second and third grounds should be determined on the assumption that the Usage Methodology "is the appropriate methodology for calculating the relevant VAT adjustment".

The implications of the wording of Ouseley J's order were the subject of submissions before us which are discussed below. It is enough to say at this point that the order circumscribes the scope of the issues before us.

Legislation

7. The system of VAT in the EU is largely governed by Council Directive 2006/112/EC on the Common System of Value Added Tax ('the Principal VAT Directive' or 'PVD'). The provisions of the PVD are implemented in the United Kingdom by the VATA94 and secondary legislation made under it.

8. Article 1 of the PVD states:

> "1. This Directive establishes the common system of value added tax (VAT).
>
> 2. The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged. On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT shall be applied up to and including the retail trade stage."

9. Section 1 VATA94 provides that VAT is charged on, among other things, the supply of goods or services in the United Kingdom (including anything treated as such a supply). Section 2 provides that VAT is charged on the supply of goods or services by reference to the value of the supply as determined under the VATA94. Section 19 provides that the value of a supply for a consideration in money shall be taken to be such amount as, with the addition of the VAT chargeable, is equal to the consideration.

10. Article 58 of the PVD provides that the place of supply of telecommunications services to a non-taxable person "shall be the place where that person is established, has his permanent address or usually resides", but this general rule is subject to a discretion granted to Member States in Article 59a. Article 59a provides:

> "In order to prevent double taxation, non-taxation or distortion of competition, Member States may, with regard to services the place of supply of which is governed by Articles 44, 45, 56, 58 and 59:
>
> > (a) consider the place of supply of any or all of those services, if situated within their territory, as being situated outside the Community if the effective use and enjoyment of the services takes place outside the Community …"

11. The UK has exercised the option in Article 59a of the PVD in relation to telecommunications services. Paragraph 8(3) of Schedule 4A to VATA94 provides:

> "8 **Telecommunication and broadcasting services**
>
> (1) This paragraph applies to a supply of services consisting of the provision of
>
> > (a) telecommunication services, or
> >
> > (b) radio or television broadcasting services.
>
> (2) In this Schedule "telecommunication services" means services relating to the transmission, emission or reception of signals, writing, images and sounds or

information of any nature by wire, radio, optical or other electromagnetic systems, including

> (a) the related transfer or assignment of the right to use capacity for such transmission, emission or reception, and
>
> (b) the provision of access to global information networks.

(3) Where

> (a) a supply of services to which this paragraph applies would otherwise be treated as made in the United Kingdom; and
>
> (b) the services are to any extent effectively used and enjoyed in a country which is not a Member State,

the supply is to be treated to that extent as made in that country."

12. The phrase "effectively used and enjoyed" is not defined in the PVD or VATA94. We were told by both parties that there is no case law of the Court of Justice of the European Union or any UK court on the meaning of 'used or enjoyed' or how the extent that a service is used/enjoyed outside the EU should be determined when no separate charge is made for such use or enjoyment. That is at the heart of Telefonica's first ground of challenge.

Evidence

13. The evidence before us was as follows. There were three witness statements from Heather Gething, Head of Tax Disputes and Investigations at Herbert Smith Freehills LLP, solicitors for Telefonica. Her first witness statement, dated 25 February 2015, was made in support of the application for permission to commence judicial review proceedings. The statement describes Telefonica's business and the services that it supplies to customers, the Revenue Methodology used and the process leading to HMRC's acceptance of it in 2008. Ms Gething also describes the Usage Methodology, the dealings between the parties in relation to it and the impact on Telefonica. Her supplemental witness statement dated 13 November 2015 sets out matters in response to HMRC's detailed grounds for contesting Telefonica's claim and a request for further information made by HMRC. The statement describes the data and analytical systems available to Telefonica, including the Directors' Reports and the Geneva customer billing system. It also describes the impact on Telefonica of the adjustment to reflect the non-EU access. It states that all prices quoted by Telefonica to its customers are inclusive of VAT although, since 2008, all bills to customers have shown VAT in relation to the fixed monthly charge. We also had two witness statements from Laura Cunningham, officer of HMRC and the customer relationship manager in relation to Telefonica, dated 13 November 2015 and 2 December 2015. Both witness statements provided HMRC's comments on the evidence of Ms Gething in her supplemental witness statement. Ms Gething's second supplemental witness statement dated 14 January 2016 deals with points made in HMRC's skeleton argument and the witness statements of Laura Cunningham in relation to the inclusion of a separate VAT line on customers' bills. Our description of the relevant facts in the next section of this decision is taken from those witness statements and the documents exhibited to them.

Factual background

14. Telefonica, trading as O2, provides mobile telecommunications services to business and private customers in the UK. Supplies to private consumers are either made on a 'pay as you go' basis where customers pay in advance for the services actually used or on the basis of a written contract under which customers pay monthly in arrears. This case is only concerned with monthly pay customers. Monthly pay customers pay a fixed charge that includes three elements, namely:

> (1) a tariff or call bundle charge which is consideration for an agreed number of voice call minutes, messages and data that the customer can use each month without incurring any additional charges.
>
> (2) an amount in consideration of the supply of the mobile phone handset, if provided, by Telefonica to the customer.
>
> (3) the network access charge which is consideration for the supply of access to a mobile telecommunications network in the UK and elsewhere.

15. In addition to the fixed monthly charge, customers pay a variable amount for any additional services. Additional services can include 'roaming' services when UK customers travel outside the EU. Telefonica is not required to account for VAT on telecommunications services effectively used and enjoyed in a non-EU country. Where a UK customer travels outside the EU, a proportion of the network access charge included in the monthly charge relates to the customer's ability to access a network in the non-EU country. That part of the network access charge ('the non-EU network access charge') is not subject to UK VAT because it relates to services that are effectively used and enjoyed outside the EU which are treated as outside the scope of UK VAT.

16. In a letter dated 27 March 2008, Telefonica submitted to HMRC a 'voluntary disclosure' claim, in accordance with section 80 VATA94, for repayment of £16,639,733 overpaid output VAT, on the basis that its VAT returns for the period January 2005 to December 2007 had not taken into account the fact that Telefonica was not required to account for VAT on the non-EU network access charge. In the letter, Telefonica explained that it had used the Revenue Methodology "to calculate the effective non EU use and enjoyment of the line rental services provided" – i.e. the non-EU network access charge. The letter then summarised that methodology as follows:

> "The methodology adopted has been to apportion between EU and non EU use and enjoyment of this service by reference to revenues. This has been done by calculating the percentage non EU call, SMS and MMS revenues represents as a proportion of total call, SMS and MMS revenues. The percentage generated from this calculation is then applied to the line rental revenues and the proportion of VAT over-declared on those revenues is then calculated.
>
> This was the only practical method by which we have been able to calculate this VAT adjustment. Moreover, it is the only method for which we have reliable, clearly auditable data and which most accurately shows the extent of non EU use and enjoyment of these telecom services."

Further details of the Revenue Methodology, including the relevant figures, were contained in appendices to Telefonica's letter of 27 March 2008.

17. Following receipt of Telefonica's letter, there was a meeting on 29 April 2008 at which Telefonica explained the Revenue Methodology to HMRC again. At the meeting, HMRC asked Telefonica to set out in writing the reasons why Telefonica would not be unjustly enriched by repayment of VAT overpaid. Section 80(3) VATA94 provides that it is a defence to a claim for repayment of VAT that the repayment would unjustly enrich the claimant. Telefonica set out its reasons in a letter dated 2 May 2008. The letter stated that Telefonica, rather than the customer, had borne the cost of the past overpayment because Telefonica's charges were stated as a VAT inclusive retail price, e.g. a £35 per month flat fee, and thus the tax was not "passed on" to the customer. The letter stated that the monthly flat fee would remain the same after HMRC accepted that part of it should be treated as outside the scope of UK VAT because:

> "The amount VAT over declared within each monthly charge is, in any event, too small to sensibly be removed from tariff pricing."

18. In an email dated 29 May 2008, HMRC confirmed their acceptance of Telefonica's voluntary disclosure claim and the Revenue Methodology used to calculate the claim.

19. In a letter to HMRC, dated 16 June 2008, ('the 16 June letter') Telefonica stated that, with HMRC's approval, it intended to use the Revenue Methodology to calculate its prospective output VAT liability for each quarterly VAT accounting period. The letter stated that Telefonica would use the previous year's figures on a provisional basis and make an adjustment in the first period after the year end. The letter then stated:

> "We shall continue to replicate this process for future years subject to any adjustment that may be necessitated by changes in law or business practice."

20. The 16 June letter set out the detailed steps of the Revenue Methodology as follows:

> "*Calculation of line rental charge and VAT adjustment*
>
> Step 1 – The top tariffs for the year (by customer number) will be selected for use as a representative sample. We will use a minimum of 10 tariffs, ensuring that sufficient tariffs are selected to cover 60% of the relevant customer base (for 2007 13 tariffs were used covering 63% of the relevant customer base).
>
> Step 2 – The expected revenue (net of VAT) for these sample tariffs is calculated as the fixed monthly fee multiplied by the duration of the contract (eg 02 35 tariff expected revenue is £35 x 40/47ths x 18 months = £536.17).
>
> Step 3 – The average cost of providing customers with a handset will then be deducted from the figure to leave the value attributable to inclusive allowances. Handset costs will be based on the actual cost of providing handsets to customers in the year (£155.51 for 2007).

Step 4 – The cost of providing any inclusive allowances will be determined. This will be based on the average costs of an on/off network minute, off-network and average cost of an SMS multiplied by actual usage by customers on the relevant tariffs over a representative period. The usage data will be based on the average actual use of inclusive minutes and SMS usage by customer tariff in the year. This will ensure that our methodology is comparable and consistent with the prior year.

Step 5 – The cost of providing any discounts will then be deducted leaving the residual amount ie the line rental value for the tariff.

Step 6 – A weighted average line rental will then be calculated by multiplying the expected revenue by tariff by the line rental value and the average number of customers for the tariff (£28.23 for 2007).

The above steps are performed on an annual basis to determine a line rental value to be used on a provisional basis for the coming year and for the purpose of the annual adjustment to be performed after the end of each year.

Step 7 – The weighted average line rental value will be multiplied by the average number of customers each quarter to determine the line rental income for the quarter.

Step 8 – Calculate the use and enjoyment apportionment percentage by dividing total non-EU roaming revenues (for all post pay customers) by total revenue excluding fixed monthly fees (for all post pay customers).

Step 9 – Multiply the value calculated at step 7 by the percentage calculated at step 8 and then multiply this value by 7/47ths to determine the output VAT that has been overpaid for the period.

The above steps will be replicated, using figures for the full year, in order to perform the annual adjustment.

We will ensure that the data used to compute the VAT adjustments is kept in a format that is readily and available clearly auditable for HMRC.

We believe that this is the most fair and reasonable way by which we can accurately calculate the line rental value and VAT adjustments. The annual adjustment will serve to ensure that output VAT adjustments are based on values and data for the relevant period i.e. all 2008 adjustments will be based on 2008 revenue and cost data.

Adjustment for quarters to March 2008 June 2008

The methodology set out above mirrors that which has now been agreed for the years to 2007 and we therefore assume that it is uncontentious. We therefore attach a calculation applying the methodology as a voluntary disclosure for the period 1 January to 31 March 2008 which illustrates the [sic] how the methodology will apply for the rest of this year. We propose that subsequent output VAT adjustments, commencing with the period 1 April to 30 June 2008, will I [sic] be included in the relevant VAT return, unless or until such time as an alternative methodology has been agreed between us."

21. HMRC replied by a letter which was undated but received on 4 August 2008 ('the 4 August letter'). They confirmed their acceptance of the Revenue Methodology, stating:

> "The methodology adopted for the year to 2007 is acceptable to HMRC for making the adjustments for future returns in 2008 and beyond."

The letter then agreed the use of provisional figures with an annual adjustment in the first period of the following year and continued:

> "This process will be applied to all the adjustment [sic] unless it becomes necessary to make changes to the methodology due to changes in law or the business."

22. On this basis, Telefonica began to make adjustments to its output VAT liability in its VAT returns to take into account the non-EU network access charge computed in accordance with the Revenue Methodology.

23. On 27 March 2009, Telefonica wrote to HMRC stating that they needed "to agree any changes to the methodology even if it works against TO2 UK (which seems likely at the present)".

24. On 2 September 2010, Telefonica sent a letter to HMRC, setting out the Revenue Methodology used to calculate the non-EU network access charge and proposing that certain adjustments should be made to the calculation of the revenues generated from Additional Services used in non-EU countries for 2009 and the first two VAT accounting periods of 2010 as well as future periods. Following this letter suggesting these changes of detail, HMRC appointed an internal auditor, David Carlin, to review their impact. Mr Carlin attended Telefonica's offices on 23 September 2010. In an email dated 12 October, HMRC confirmed that they were happy with the calculations and that Telefonica could make the proposed adjustment for 2009/10. HMRC continued to accept Telefonica's VAT returns completed in accordance with the revised Revenue Methodology.

25. In May 2013, HMRC hosted a meeting with representatives of the telecommunications industry to discuss the new place of supply rules for intra-EU supplies that were to come into force on 1 January 2015 and, at the same time, HMRC raised the issue of how the non-EU use and enjoyment measure, ie the calculation of the non-EU network access charge, could be improved by reference to actual rather than estimated data.

26. On 3 July 2013, HMRC wrote to Telefonica referring to the meeting with the representatives of the telecommunications sector in May and stating:

> "As part of the discussion HMRC outlined our position on the use of estimation in calculating use and enjoyment of broadband and line rental [ie network access] charges. We believe that since HMRC agreed a methodology with you for calculating these charges, the technological advances in data systems have improved the capability for both capturing and storing customer data. Consequently, we consider that sufficient data is now held within customer accounting systems to allow for direct measurement of services used by customers outside the EU. Given our concerns on the use of estimation in calculating the VAT figures for returns and error correction notices, we believe that where accurate figures are held within customer accounting systems, they should always be used in returns and claims.

> The 2015 changes to places of supply rules will require telecommunication suppliers to carry out reviews of their accounting systems. I hope you will agree that this provides a good opportunity to review the methodology used to arrive at the effective use and enjoyment on these supplies. We would, therefore, like to work with you to discuss the methodology you propose to use to allow you to accurately calculate the effective use and enjoyment on these services."

27. On 20 February 2014, HMRC and Telefonica's VAT team met for what the minutes described as a 'VAT Introductory Meeting' at which a number of VAT issues were discussed. One issue was the calculation of the non-EU network access charge. The minutes of this meeting record as follows:

> "HMRC were aware of [Telefonica's] existing methodology which had been in place since 2008. This was based on a values split which HMRC considered gives a distorted result because the cost of non-EU roaming was much higher than that in the UK (EU), whereas actual usage outside the EU (in terms of minutes) was lower. A claim based on value splits had been previously agreed across the industry, primarily because there was lack of technology available within the industry at that time to identify a split based on usage. However it was HMRC's view that technology had changed and it was [now] possible to use a usage based method to give a more accurate result.
>
> [HMRC] asked if [Telefonica] could go back to the original methodology and to consider whether it should now be revised given the changes in technology and also the way that people made use of their phones outside the EU. [Telefonica] agreed to do this and then to speak to [HMRC] and the team regarding the [position] and agree a way forward.
>
> [Telefonica] suggested that it would be helpful to try and define "usage", e.g. whether this was voice minutes, number of texts or volume of data, and how this can be measured inside and outside the EU.
>
> [Telefonica] commented that the non-EU 'use and enjoyment' includes not only usage but also the 'enjoyment' element, perhaps implying that customers expected to pay a premium for this (i.e. higher value)."

28. Following the meeting, HMRC emailed Telefonica on 7 March 2014 with a summary of "current open issues". In relation to the issue of 'Use and Enjoyment', the current position was described as "HMRC have explained reasons for seeking a revised methodology and sought agreement on how to take this forward in [sic] O2". Under the heading "Next Action", the list stated "O2 to provide details of what they consider would be an appropriate methodology for discussion". The "Anticipated Timescale" is shown as by the end of May 2014.

29. On 14 April 2014, Telefonica sent an email to HMRC attaching a copy of a letter dated 12 March from Vodafone to HMRC. The Vodafone letter set out why Vodafone considered that HMRC's proposal to use the volume of calls, eg by reference to number of minutes used, as a proxy for use and enjoyment to determine the amount of the non-EU network access charge was not appropriate. Vodafone explained that using value as a proxy was consistent with the overall scheme of VAT and any usage-based methodology would be impractical. In the email, Telefonica stated:

> "At Telefonica we have been looking at the question as well. We have a meeting booked this morning with various people to explore possible alternatives to a revenue basis of calculation. We have an open mind on the matter, albeit the early signs are that calculating volume usage would be very complex. This point is reflected in the Vodafone letter.
>
> In terms of what happens next, we will update you on what comes out of our meeting today re analysing non EU use and enjoyment. The Vodafone letter essentially challenges the legal/conceptual rationale behind any move away from the revenue based method of calculation. If you could keep us appraised of the overall HMRC policy on this issue, that would be appreciated."

30. Around or shortly after the time when Telefonica sent the 14 April email to HMRC, Telefonica was contacted by Ernst & Young which was trying to co-ordinate an industry-wide response to potential changes to the determination of non-EU use and enjoyment and the calculation of the non-EU network access charge. Telefonica attended a meeting with other telecommunications companies set up by Ernst & Young on 25 June. Following the meeting, Ernst & Young sent a letter dated 5 August to HMRC. The letter stated that Ernst & Young understood that HMRC was reviewing the methodologies used by telecoms companies to calculate the non-EU network access charge and had had bilateral discussions with some of them. The letter stated that:

> "… changes to the methodologies currently in use may have ramifications for pricing, margins and internal operations such as systems and processes. For example, there are significant and non-trivial issues caused by the difficulty of accessing the data that could be required under some approaches".

31. Ernst & Young proposed that there should be a meeting, hosted by Ernst & Young, between HMRC and up to ten telecommunications service providers to discuss the proposed changes to the methodology and their impact. In the event, no such meeting took place.

32. On 26 November 2014, HMRC issued a document headed "Use and Enjoyment: HMRC position paper November 2014" (the 'November Position Paper'). The November Position Paper stated:

> "This paper outlines HMRC's position on the application of the VAT provisions for outside the EU use and enjoyment ('U&E') of business to customer (B2C) mobile telephone and broadband services.
>
> HMRC first communicated its intention to re-examine this issue, with a view to agreeing more accurate calculation methods, in May 2013. The aim was and is to agree new methodologies to apply from 1 January 2015, to coincide with the changed the place of supply rules for B2C telecoms services.
>
> Since then each affected business will have been contacted by their Customer Relationship Manager to discuss this issue. The concerns and issues arising from these individual meetings have been fed back to the HMRC project team responsible for this issue, who have used this feedback to refine HMRC's policy position and to seek internal legal advice."

33. The paper then set out the relevant legislation and noted that:

"There is little comment or case law which provides further explanation on how the term 'effective use and enjoyment' should be interpreted. However, HMRC considers that paragraph 8(3), Schedule 4A VATA requires a service to be consumed outside the EU to qualify for relief. The term 'effective', included in both PVD and VAT Act 1994, implies actual enjoyment, rather than, for example, the existence of a right that is not exercised, and supports the interpretation of consumption."

34. The paper then set out how the concept of use and enjoyment applies to broadband and mobile services, which is not relevant to this case, before dealing with mobile telecommunications as follows:

"***Background***

Contract consumers pay a fixed monthly amount, referred to in the following as the monthly recurring charge ('MRC'). This entitles them to a bundle of different telecommunication services from the mobile provider e.g.: UK calls, texts, data, etc. The exact make up of the bundle and its cost will vary from tariff to tariff.

A SIM card is provided to the customer and this allows the customer access to the services in his/her bundle.

The MRC will often also include an amount towards the supply of a phone.

International calls, texts, data etc are not normally included in standard monthly bundle and are charged for separately, in addition to the MRC. Services used outside the EU normally costs significantly more than the UK or EU equivalent.

…

MRC – 'standard' contracts

Although there is no specific element of 'line rental' included in the monthly bundle, the MRC entitles a customer to 'network access'. Services accessed from outside the UK do not use the provider's UK network; however they do require the purchase of a package and the use of the SIM and are generally slightly cheaper than non-UK services accessed on pay as you go contracts. HMRC accepts, therefore, that a U&E adjustment is applicable to a 'network access' element of the MRC, but considers that this should be relatively low.

We would also accept that any U&E adjustment can apply to the element of the MRC which relates to the supply of the phone handset."

35. The November Position Paper then set out how, in HMRC's view, the adjustment should be made:

"***Physical usage rather than value***

The adjustment should be made on the basis of comparative usage - that is minutes spent, number of texts, data consumed/access occasions outside the EU as a portion of total consumption of each feature.

Comparative revenue is not a fair and reasonable basis for the apportionment as outside the EU charges are generally much higher than the equivalent charge inside the EU and such a comparison would therefore be distortive. Mobile operators already receive relief on these higher call charges, as individual outside the EU calls, etc, are already treated as outside the scope of UK VAT.

> ***Calculation methodology: evidence required***
>
> The basis for any calculation should be direct usage data held by the business. We believe mobile providers already have the potential to access this data. HMRC will not accept indirect data as the basis for calculation.
>
> Any calculation method should avoid the use of estimation wherever possible. HMRC will, however, consider any calculation methodology which produces a fair and reasonable result. …"

The November Position Paper required mobile telecommunication providers such as Telefonica to stop using their Revenue Methodology by 31 December 2014.

36. On 8 December 2014, HMRC held a meeting with mobile telecommunications providers affected by the November Position Paper, including Telefonica. The slides used for the meeting showed the process in relation to the new methodologies for determining the use and enjoyment of broadband and mobile services outside the EU as follows:

> "Initial meeting – May 2013
>
> Follow up letters from HMRC to businesses – June/July 2013
>
> Individual meetings between case teams and businesses
>
> Legal advice – September 2014
>
> Position paper – November 2014
>
> This meeting – December 2014"

37. Shortly after the meeting in December 2014, HMRC issued a document headed "Use and Enjoyment of B2C Broadband and Mobile Services December 2014" responding to a number of points raised by telecommunications providers at the meeting and in correspondence. HMRC sent the note to Telefonica on 19 December 2014. The note stated that:

> "HMRC has not yet received comments from all affected customers and an updated position paper will be issued once we have received these further responses."

38. At a further meeting on 12 February 2015, Telefonica stated that they "did have usage data available at a high level", but that "they had been unable to come up with a workable compromise as an alternative to either a values or usage based method". They explained their intention to seek a Judicial Review of

> "HMRC's decision to adopt the Usage Methodology in place of the Revenue Methodology to calculate the amount of the Line Rental charge attributable to the use and enjoyment of the Service outside of the European Union, as demonstrated by the circulation of the Position Paper to Telefonica on 26 November 2014."

39. Herbert Smith Freehills, acting on behalf of Telefonica, sent a Pre-Action Protocol ('PAP') letter to HMRC on 13 February 2015. On 2 March 2015, HMRC replied to the PAP letter. At the end of that response, HMRC said that:

> "HMRC has taken note of the points raised by Telefonica and by other taxpayers and recognises that taxpayers may need more than one month in which to adjust their forecasts and, where necessary, to update systems to enable them to comply with the usage principle.
>
> Therefore, in the interests of preserving the spirit of collaboration, HMRC has decided to offer taxpayers who have existing use and enjoyment agreements with no end date a short extension to the envisaged transitional period. This will mean that HMRC will accept use and enjoyment adjustments based on such existing agreed methodologies, without variation, for VAT return periods up until 31 March 2015".

40. On 26 March, HMRC issued an updated position paper (the 'March Position Paper'), repeating their position that telecommunications providers had to use a Usage Methodology and that this had to take effect from 31 March 2015.

Is the Usage Methodology unlawful?

41. Telefonica's first ground of challenge to the Decision is that HMRC's proposed Usage Methodology is, as a matter of construction, contrary to EU and UK VAT legislation and thus unlawful. Mr Grodzinski QC submitted that Article 1 PVD showed that VAT is a tax on consumption based on value. He said that this was reflected in section 2 VATA94, under which VAT is charged on the value of the supply, and section 19 which provides that, where the consideration is in money, the value of the supply is equal to the amount of money less the VAT chargeable, ie the monetary consideration is the value of the supply plus the VAT chargeable. He contended that "use and enjoyment" must be construed against the background that VAT is a tax on consumption measured by value so that any methodology used to apportion a lump sum payment for a service must be based on the value properly ascribed to it. Mr Grodzinski submitted that, in ascertaining use outside the EU, Article 59a and the UK implementing legislation was necessarily concerned with economic use. He contended that the legal error at the heart of the Usage Methodology is that it attributes the same value to access to the network in the UK as to access to the network outside the EU. He argued that a methodology that takes no account of revenues, ie ignores the fact that calls, texts and data are more expensive outside the EU than in the UK or other EU member states, is unlawful because it ignores the greater value of a non-EU network access service to customers. He said that Telefonica's Revenue Methodology recognises that customers place a higher value on calls made outside the EU than to calls made within the EU – that is why they are prepared to pay more for them. On that basis, the Revenue Methodology could not be described as distortive simply because it ascribed greater value to non-EU access than the Usage Methodology - rather it properly reflected the greater value placed on calls by customers.

42. Mr Grodzinski referred to the partial exemption standard and special methods under regulation 101 and following of the VAT Regulations 1995 for determining how much input tax is attributable to taxable supplies. He submitted that the regulations are not concerned with use alone but also with values. Where a taxable person uses a special method to calculate its partial exemption position, that method is concerned with use in economic terms. In support of that proposition, Mr Grodzinski

referred to the decision of the Court of Appeal in *London Clubs Management Ltd v HMRC* [2012] STC 388 which endorsed the comment of Warren J in *St Helen's School Northwood Ltd v HMRC* [2007] STC 633 that 'use' in regulation 101 is not physical use but economic use. He accepted that the question in this case is not the same as a case concerning partial exemption but submitted that the underlying principles in the *London Clubs* and *St Helen's* cases show that ignoring the cost of calls outside the EU is inconsistent with economic reality. Mr Grodzinski accepted that Telefonica made the same charge for network access line rental to all customers whether they were using the service in the UK or outside the EU. The monthly recurring charge did not split out charges and does not make different charges depending on location. But he submitted that the value of the ability to send and receive text for calls in the UK was not the same as the ability to do so in, say, the United States. Mr Grodzinski submitted that customers placed a higher value on the ability to use their phones in a non-EU country than in the UK. The customers demonstrate this, he argues, by using their phones outside the EU even though they know that they must pay a higher charge for that call than they would pay if they were making the call within the EU.

43. Ms Simor QC submitted that there is nothing in the statutory language that prohibits the use of a methodology based on usage. Further, there is nothing to say the revenue received must be used to measure use and enjoyment. She contended that there is no correlation between the cost of providing network access outside the EU and charges for making calls abroad. She stated that it is wrong to say that the consumer has agreed to pay a higher value for non-EU network access. In fact, the consumer pays the same for network access when he or she is in the UK as when outside the EU. In any event, effective use and enjoyment simply means consumption.

44. The issue in Telefonica's first ground of challenge is whether, as a question of statutory construction, HMRC's proposed Usage Methodology is contrary to EU and UK legislation. In construing Article 59a and paragraph 8(3) of Schedule 4A to VATA94, we keep in mind that the purpose of those provisions is to determine the place of supply.

45. We have not found the legislation and case law relating to the attribution of input tax under a partial exemption method to be of assistance in deciding this issue. The purpose of partial exemption methods is to establish the extent to which inputs, ie supplies made to the taxable person, are attributable to outputs, ie supplies made by the taxable person. In *London Clubs*, which concerned inputs that were not directly attributable solely to either taxable or exempt supplies by the business alone but were attributable to both, the Court of Appeal held, at [34], that:

> "In assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the asset, that is to say having regard to economic reality, in the light of the observable terms and features of the taxpayer's business."

46. The Court in *London Clubs* did not say that economic use was the only factor to be considered. It is clear that physical use can also be a relevant factor. In cases

where inputs are consumed in producing specific goods, physical use may be the predominant factor.

47. However, we consider the approach in *London Clubs* helpful to this extent, that we respectfully agree that, in making any assessment of use, it is essential to have regard to economic reality in the light of the observable terms and features of the taxpayer's business. In our view, neither the legislation on place of supply generally nor the phrase "use and enjoyment" in Article 59a PVD requires consideration of an economic use to the exclusion of other measures of use. The place where a supply is made is a physical attribute. When determining where a service is to be treated as being made, eg by reference to where it is used and enjoyed, it may be appropriate to look at the physical use or enjoyment of the service. That may not always be the most appropriate factor for determining the place of supply and it is necessary to consider the economic reality of the supply in the light of all the circumstances.

48. In relation to the meaning of 'use' and 'enjoyment', Ms Simor referred us to other language versions of Article 59a which sometimes appeared to use a term closer to 'exploitation' rather than 'enjoyment'. We did not find that those versions assisted in defining what is meant by 'use and enjoyment' beyond conveying a general sense that the recipient must do something with the supply. We do not consider that the different terms employed (use, enjoyment and exploitation) signify materially different criteria for determining the place of supply.

49. Mr Grodzinski argued that the inclusion of the words 'and enjoyment' in addition to the word 'use' must mean that something in addition to simple 'use' must be relevant to the identification of the place of supply. We disagree with that analysis. We do not consider that it is necessary to give some separate meaning to the word 'enjoyment' when talking about a service that is clearly used as in this case. Whatever 'enjoyment' means, it does not justify determining the place of supply of the network access service according to how much customers value the service as opposed to what they actually pay for it. The term 'use and enjoyment' should not be artificially dissected. In the case of some services referred to in Article 59a, it may be more appropriate to describe them as being 'used' in a particular place whereas a different service may more appropriately be described as 'enjoyed' or 'exploited'. In some cases, it may be equally appropriate to speak of a service being both used and enjoyed. We do not therefore accept that the inclusion of the words 'and enjoyment' requires some concept of the value of the services to be imported into the consideration of where the services are supplied.

50. In our view, the starting point is to identify the supply. In this case, there is no dispute that the service supplied by Telefonica to its customers is the ability to access a telecommunications network, where available, in the UK and elsewhere. We are not concerned in this case with the supply of the telecommunications ie the actual calls, text or data made, sent or received by the customers. Those services are, when supplied outside the EU, the subject of separate charges and there is no dispute about their VAT treatment.

51. Having identified the supply, the next step is to decide what is meant by 'effective use and enjoyment' of the ability to access a telecommunications network for the purpose of determining the place of supply. As set out in the November Position Paper, HMRC's position (and we did not understand Telefonica to challenge this) is that the term 'effective', in both PVD and VATA94, implies actual enjoyment of the ability to access the network outside the EU rather than the mere grant of the right to such access when it is not, in fact, exercised.

52. We consider that words 'effective use and enjoyment' in Article 59a PVD and 'effectively used and enjoyed' in paragraph 8 of Schedule 4A to VATA94 require more than the mere ability to access a network. In our view, that service is only effectively used and enjoyed when it is actually accessed, ie used to make or receive calls and send or receive texts and data.

53. We acknowledge that customers who do not make any calls etc do not use the network access service but nevertheless enjoy it in the sense that they have the ability to do so if they wish. It could be argued that those customers have paid the network access charge for the right to access the network anywhere in the world where such a network is available and enjoy that service when they are outside the EU whether they avail themselves of it or not. We do not consider that merely having a mobile phone in a non-EU location where a network is available is effective use and enjoyment in that location. A customer who, when outside the EU, keeps his phone switched off or turns off data roaming, still retains the ability to turn it on and access the network but, in our view, such a person cannot be said to be effectively using and enjoying the service when he has deliberately cut himself off from such access. The same is true for a person who has the phone switched on but neither makes nor receives calls etc. We accept that a person whether in the EU or outside still receives a supply of services even if he does not turn on his mobile phone for the whole month – he still agrees to pay the consideration for that supply in the form of the monthly access charge. In those circumstances, the customer has received a service but, in our view, cannot be regarded as having effectively used and enjoyed the service for the purposes of determining its place of supply under Article 59a PVD.

54. Having regard to all the circumstances and the economic reality of Telefonica's supply to customers, we consider that, for the purposes of determining the place of supply, 'effective use and enjoyment' requires some actual use of the network to make, send or receive calls, text or data. The extent of the use and enjoyment of access may be greater than is reflected in actual calls or texts made, for example if the customer accesses the network by receiving calls and texts when outside the EU under a tariff which does not charge for receiving such calls. Accordingly, it is clear that some form of proxy must be used to determine the extent of the effective use and enjoyment. In this case, both parties take actual access to the network, ie making calls, sending texts or downloading data, as the appropriate proxy although they differ as to how that should be measured.

55. The final step is to determine how the monthly network access charge is to be apportioned between EU and non-EU locations where a service is used and enjoyed in more than one place. Both the Revenue Methodology and the Usage Methodology

rely on the customer's actual chargeable use of networks as a proxy for the benefit he enjoys from the availability of networks to him. Both methods rely on comparing the proportion of actual access to the overseas networks to the total actual access to all networks over the month for which the access charge is imposed. The difference is whether the proportion is calculated by using, e.g. the minutes used by the customer when accessing the overseas networks compared to all minutes used (in the Usage Methodology) or the charges made for the minutes used by the customer when accessing the overseas networks compared to total charges for minutes used (in the Revenue Methodology).

56. As we have agreed that "effective use and enjoyment" requires more than the mere right to access the network, it seems to us that use and enjoyment must be measured by reference to actual access. The most accurate method of apportionment would be to use the time a customer has access to the telecommunications network outside the EU (ie time spent with a mobile phone with roaming switched on) in each monthly charging period. As discussed above, it appears that it is necessary to use a proxy for such access, ie actual calls, texts or data made and sent or received.

57. It is clear that customers pay more to make calls, send texts or receive data when outside the EU but that does not, in our view, show that they value the ability to access the network outside the EU more highly than in the EU. It seems to us that such a value is subjective and may depend on a number of factors other than the location of the customers when they wish to access the telecommunications network. Telefonica charges its customers a monthly network access charge for the ability to access the network during the relevant month. The network access charge remains the same whether the customer accesses the network in the UK or in a non-EU country (although there will be additional charges for calls, text and data outside the EU). As Telefonica charges the same for access to the network in the EU and outside the EU, it is not possible, in our view, to say that customers placed a higher value on the non-EU network access services. There is no evidence which suggests that the actual costs to Telefonica of providing access to networks outside the EU are correlated with the costs of providing the actual calls made by customers from outside the EU. Although customers manifest their agreement to pay more for making calls from outside the EU by in fact making those calls under a tariff which charges them more, they have not manifested a similar agreement to pay more for network access from outside the EU because the monthly charge for access does not charge them more for that access.

58. HMRC have suggested the Usage Methodology. Ms Simor submitted that there is nothing in the wording or purpose of the legislation that precludes an approach to determining use and enjoyment based on actual usage. We agree. The PVD and paragraph 8(3) of Schedule 4A to VATA94 do not explicitly or by necessary implication prohibit the Usage Methodology.

59. That does not mean that the Revenue Methodology is necessarily unlawful. We do not need to decide that point because the only issue before us in the first ground is whether the Usage Methodology is unlawful. Our conclusion on this ground is that

Telefonica has not established that the Usage Methodology is unlawful, i.e. contrary to the legislation construed properly.

Approach to legitimate expectation grounds

60. In granting Telefonica permission to bring its claim based on substantive and procedural legitimate expectation, Ouseley J directed that the grounds should be determined "on the assumption that HMRC's proposed 'usage methodology' is the appropriate methodology for calculating the relevant VAT adjustment". Ms Simor contended that if we reject Telefonica's arguments on the first ground, we must approach the legitimate expectation grounds on the basis set out by Ouseley J. We agree. Ms Simor argued further that if we dismiss Ground 1, we must approach the legitimate expectation grounds on the basis that Telefonica must overcome the very high hurdle of establishing that they had a legitimate expectation that HMRC would accept an **unlawful** method of calculating the relevant VAT adjustment. We do not, however, accept her submission that Ouseley J's direction means that we must assume that the Revenue Methodology is unlawful. The assumption that the Usage Methodology is appropriate does not lead to the conclusion that the Revenue Methodology is unlawful. A decision of the First-tier Tribunal, which is the appropriate forum for such matters, that one methodology is the appropriate way to calculate an apportionment for the purposes of determining the place of supply is not a decision that another methodology is unlawful.

61. Ms Simor submitted that Telefonica had conceded that the Revenue Methodology was unlawful at the hearing before Ouseley J and that they should be bound by that concession before us. We were referred to the transcript of the hearing before Ouseley J and find that, as is often the case, the meaning of exchanges recorded between judge and counsel are not as clear on the page as perhaps they were in Court. We rely on the terms of the direction as made rather than the comments made in the course of submissions that led to it. We approach the issue of legitimate expectation on the basis that, as we have found, the Usage Methodology is not unlawful and on the assumption that it is the appropriate methodology for calculating the extent to which the network access was effectively used and enjoyed outside the EU. We would expect a much clearer direction from the learned judge if he intended us to go further and assume that the Revenue Methodology is unlawful.

Doctrine of legitimate expectation

62. The second ground of Telefonica's claim asserts that Telefonica has a substantive legitimate expectation that it would be able to continue to use the Revenue Methodology until such time as the law or its business changed in a relevant way, that is, in a way which undermined the appropriateness of the methodology. This expectation is said to arise from the wording of the 4 August letter accepting that the Revenue Methodology should continue to be used unless it becomes necessary to make changes to the methodology due to changes in law or in Telefonica's business.

63. Further, Telefonica contends that '[t]his expectation was reinforced by HMRC's continued acceptance' of Telefonica's calculations based on the Revenue Methodology and 'by the fact that there was no suggestion, following Telefonica's

letter in September 2010 or in Mr Carlin's subsequent audit, that the [Revenue] Methodology was in any way inappropriate'.

64. Finally, Telefonica say that no cogent and proportionate justification has been put forward for HMRC to resile from their previous position.

The relevant case law

65. The doctrine of substantive legitimate expectation is well established in public law. The leading case on the application of these principles in the context of the relationship between HMRC and a taxpayer is *R v Inland Revenue Commissioners ex parte MFK Underwriting Agencies Ltd* [1989] STC 873 ('*MFK*'). In *MFK* the claimants were proposing to issue index-linked bonds to be marketed in particular to Lloyd's Names and wanted to know whether the Names' gains on disposal of bonds issued on the proposed terms would be treated as income or as capital gains. There was extensive correspondence and various meetings between the Revenue and the claimants and their advisers in the course of which it was alleged that the Revenue gave an assurance as to the future tax treatment of the interest generated by the bonds.

66. Bingham LJ noted that the Revenue accepted that a proper part of its function was when possible to advise the public of their rights as well as their duties and generally to encourage cooperation between HMRC and the public. He stated 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. … 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, but the necessity in my view exists here. First, it is necessary that the taxpayer should have put all his cards face upwards on the table. This means that he must give full details of the specific transaction on which he seeks the Revenue's ruling, unless it is the same as an earlier transaction on which a ruling has already been given. It means that 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 forego any claim to tax on any other basis. It means that the taxpayer must make plain that a fully considered ruling is sought. It means, I think, that the taxpayer should indicate the use he intends to make of any ruling given. This is not because the Revenue would wish to favour one class of taxpayers at the expense of another but 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."

67. Having examined the extensive correspondence in that case, Bingham LJ concluded that the Revenue had not promised to follow, or indicated that it would follow, a certain course so as to render any departure from that course unfair – there was accordingly no abuse of power. The other member of the Divisional Court in *MFK* was Judge J (as he then was). He described the legal position in the following terms: page 896

> "In the present case the Revenue promulgated a number of guidelines and answered questions by or on behalf of taxpayers about the likely approach to a number of given problems. The Revenue is not bound to give any guidance at all. If however the taxpayer approaches the Revenue with clear and precise proposals about the future conduct of his fiscal affairs and receives an unequivocal statement about how they will be treated for tax purposes if implemented, the Revenue should in my judgment be subject to judicial review on grounds of unfair abuse of power if it peremptorily decides that it will not be bound by such statements when the taxpayer has relied on them. The same principle should apply to Revenue statements of policy. …"

68. Judge J agreed with Bingham LJ that the evidence did not establish an abuse of power by the Revenue. If the evidence had established an abuse of power he would have granted the application although he "recognised that it is only in an exceptional case of this kind that the process of judicial review is permitted and the court should be extremely wary of deciding to be unfair actions which the commissioners themselves have determined are fair".

69. More recently the principles have been applied by Leggatt J in *R (GSTS Pathology LLP & Ors) v Revenue and Customs Commissioners* [2013] EWHC 1801 (Admin) ('*GSTS*'). In that case the claimants were parties to a proposed joint venture to provide pathology services to the NHS. Because of the importance of knowing how VAT would apply to the supplies to be made by the proposed joint venture, the claimant requested a ruling from HMRC before entering into any contractual arrangement. In response to this request, HMRC wrote to the claimant indicating that the supplies would be treated as taxable at the standard rate. After the joint venture had been formed and started trading, HMRC wrote to the company saying that contrary to the earlier letter, the supplies would be treated as exempt. The judicial review challenge was brought in parallel to tribunal proceedings to determine whether the supplies were in fact subject to VAT or exempt. Leggatt J summarised the applicable law at [72]-[73] as follows:

> "72 The principle that legitimate expectation should be protected is now well established as a ground for judicial review. For this principle to apply, the general requirements are: (1) the claimant has an expectation of being treated in a particular way favourable to the claimant by the defendant public authority; (2) the authority has caused the claimant to have that expectation by words or conduct; (3) the claimant's expectation is legitimate; (4) it would be an unjust exercise of power for the authority to frustrate the claimant's expectation. Although it has sometimes been said to be a requirement also that the claimant has relied to its detriment on what the public authority has said, the law now seems to be clear that such detrimental reliance is not essential but is relevant to the question of whether it would be an unjust exercise of power for the authority to frustrate the claimant's expectation (see, eg, *R (On*

> *Application of Bancoult) v Secretary of State for Foreign & Commonwealth Affairs (No 2)* [2009] AC 413 , paragraph 6, per Lord Hoffmann)."

70. Applying those principles to the facts of the case before him, the learned judge noted that the change in the interpretation of the law by HMRC was not the result of any change in legislation or by any subsequent court ruling – all that had happened was that HMRC had changed their view of how the law should be interpreted because of a change in the personnel dealing with the matter: [95]. He went on:

> "96. What is the claimants' legitimate expectation or what does fairness require from HMRC in these circumstances? On the one hand, it can be said that if tax treatment stated by HMRC in a ruling to be correct can change - not as a result of any change in the law but just because HMRC has changed its view - the value of such rulings and the practice of giving them will be very substantially undermined. The taxpayer is surely entitled to expect consistency and not that a public authority will change its mind without any objective change in circumstances.
>
> 97. The counter argument is that HMRC cannot reasonably be obliged to perpetuate indefinitely what is now considered to be a mistaken interpretation of the law. To do so would be inconsistent with its duty to collect what it believes to be the correct amount of tax required by law.
>
> 98. Where the balance is struck between these competing arguments may depend on the particular facts of the case. A number of features in the present case - in combination - have led me to conclude that HMRC cannot, without unfairness to the claimants, impose a different tax treatment from that stated in the rulings without any objective change in circumstances.
>
> 99. These features are: (1) the extent of the reliance which the claimants have placed on the rulings in setting up and investing in their business and the very serious and damaging consequences the proposed change in tax treatment will have if implemented; (2) the fact that the extent of the reliance which would be placed on the rulings was made clear to HMRC when the rulings were sought; (3) the fact that the rulings were and remain consistent with the general published guidance issued by HMRC in VAT Notice 701/31; (4) the fact that the point on which the rulings were given was and remains, in my view, an arguably correct interpretation of the law; (5) the fact that it is very unlikely on the current state of the law that the claimants will be entitled to recover compensation for losses suffered as a result of their reliance on the rulings if they are now subjected to a different tax treatment; (6) the fact that if the claimants are required to adopt the new tax treatment before the issue on which the rulings were given has been authoritatively determined by the tribunal they may feel compelled to restructure their affairs in a way which would be costly and detrimental and, in practice, irreversible and yet to turn out to have been unnecessary if the tribunal finds that the rulings were legally correct."

71. Leggatt J then went on to consider whether it was just to allow HMRC to resile from its earlier indication because "even where a claimant has a legitimate expectation, which it would be unfair to the claimant for the public authority which produces that expectation to frustrate, it is nevertheless permissible for the authority to do so if there is an overriding public interest that requires it." (para 103). He held that there was no such justification.

72. Both *GSTS* and *MFK* are examples of legitimate expectation cases brought against HMRC where the taxpayer had clearly and deliberately sought an assurance from HMRC about the future tax treatment of proposed conduct in order to decide whether to engage in such conduct at all or how to structure and implement a proposed transaction. There are other cases where the legitimate expectation is said to arise from publicly available guidance or policy published by HMRC on particular tax issues. In *R (Davies and Another) v HMRC and R (Gaines-Cooper) v HMRC* [2011] UKSC 47 ('*Gaines-Cooper*') the Supreme Court considered whether a booklet published by HMRC dealing with when people are regarded as resident in the UK for tax purposes created a legitimate expectation that the principles set out in the booklet would be applied. The Supreme Court dismissed the claim holding that the requirements specified by Bingham LJ in *MFK* that the statement relied on must be clear, unambiguous and devoid of relevant qualification applied as much to a statement in a booklet published to the whole world as it did to an assurance given to an individual tax payer. The Supreme Court did not consider the booklet contained any assurance capable of giving rise to a legitimate expectation. In *Cameron and others v HMRC* [2012] EWHC 1174 (Admin) ('*Cameron*') Wyn Williams J considered whether a legitimate expectation had been created among seafarers as to how the Revenue would determine the number of days on which they were treated as performing their employment duties outside the UK when they were on board ship. The Revenue had issued a publication referred to as 'the Blue Book' in which the Revenue said it would treat a vessel as having left the UK as soon as it left its berth or anchorage on a voyage that would take it outside UK territorial waters. Wyn Williams J referred to *MFK* and to *Gaines-Cooper* and held that the Blue Book contained an unequivocal statement of the concession to be applied unqualified by anything else in the booklet. He upheld the claims for judicial review.

73. There are two further points raised in *Cameron* that are useful to note here. The first is that, although the case was one of substantive legitimate expectation, the learned judge dealt with the questions: if the claimant did acquire a legitimate expectation that he would be taxed in accordance with the broad concession, did there come a time when the legitimate expectation ceased? Viewed another way, did there come a time when the taxpayer's reliance on HMRC's representations ceases to be reasonable? He answered the question in this way:

> "70. In my judgment the answer to these questions must be sought by reference to the manner and extent of the publication of the broad concession. The Claimants allege that the broad concession was published in a formal document produced by the Defendants (the Blue Book) which had as its aim the provision of assistance to seafarers who were contemplating making a claim for FED [*sc. Foreign Earnings Deduction*]. The Blue Book was aimed at all those seafarers who were eligible, potentially, to claim FED. Assuming for the moment that the terms of the broad concession within the Blue Book were clear and capable of founding a legitimate expectation, my judgment is that the Defendants would remain bound by the broad concession until they had given notice to all seafarers potentially eligible to claim FED/SED [*sc. seafarers' earnings deduction]* that the concession was to be withdrawn or altered. It is not for me to lay down prescriptive rules about how such notice could be given. However, effective notice of a

> change could be given only if there was publication in some form to the whole class of potentially eligible taxpayers."

74. Secondly, the judge in *Cameron* considered whether it was necessary for the claimants to show that they had relied on the statement in the Blue Book to their detriment. He held that the law in relation to this issue is as stated in the speech of Lord Hoffmann in *R (Bancoult) v Secretary of State for Foreign & Commonwealth Affairs (No 2)* [2009] 1 AC 453. At page 488 Lord Hoffmann said:-

> "60. …. It is not essential that the Applicant should have relied upon the promise to his detriment, although this is a relevant consideration in deciding whether the adoption of a policy in conflict with the promise would be an abuse of power and such a change of policy may be justified in the public interest, particularly in the area of what Laws LJ called "the macro-political field": see *R v Secretary of State for Education & Employment, ex p Begbie* [2000] 1 WLR 1115, 1131."

75. This accords with the judgment of Leggatt J in *GSTS* where he said the law now seems to be clear that such detrimental reliance is not essential but is relevant to the question of whether it would be an unjust exercise of power for the authority to frustrate the claimant's expectation: see paragraph [72] of *GSTS*.

76. We recognise that even where no legitimate expectation is generated by a statement by HMRC, there may be exceptional cases where HMRC's conduct towards a taxpayer makes it an abuse of power for HMRC to attempt to impose an assessment to tax on a basis contrary to the basis it has applied in the past. In *R v Inland Revenue Commissioners, ex parte Unilever plc* [1996] STC 681 the Court of Appeal was considering a situation which has some similarities to the instant case. There a practice had grown up over twenty years between Unilever and HMRC whereby Unilever's tax computations had been submitted more than two years after the end of the accounting period to which they related but the Revenue had not refused the company's claims to loss relief against profits of the current year on the grounds that they were out of time. HMRC submitted to the Court of Appeal that there had been no clear, unambiguous and unqualified representation by the Revenue, oral or written, such as was held to be necessary in *MFK* before it could be held unfair for the Revenue to do its duty. The Revenue's conduct, on 30 occasions over 20 years, could not be relied on as making such a representation. In any event, the conduct relied on was silence and inaction, in failing to point out and disallow late claims. Whilst recognising the strength of those points, Bingham MR said that the application of those principles would cause him unease if they compelled him to reject Unilever's claim: [page 690]

> "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."

77. An important factor in that case was that the concession lay only in not enforcing a time limit for allowing a deduction of losses from profits; it did not result in the Revenue having to forgive tax which Parliament had ordained should be collected. On

the contrary, disallowing reliance on the losses would lead, Bingham MR said to "an adventitious windfall, accruing to the Revenue through the understandable error of an honest and compliant taxpayer, shared over many years by the Revenue." Bingham MR concluded:

> "These points cumulatively persuade me that on the unique facts of this case the Revenue's argument should be rejected. On the history here, I consider that to reject Unilever's claims in reliance on the time-limit, without clear and general advance notice, is so unfair as to amount to an abuse of power. …"

78. In a concurring judgment, Simon Brown LJ made clear that he was **not** deciding the case on the basis that there was a substantive legitimate expectation:

> "Such a claim, [HMRC] submits and I would accept, Unilever cannot here make good: the fundamental requirement for an unqualified and unambiguous representation is missing, there being, as Unilever acknowledge, no conscious practice or policy on the part of the Revenue to allow late claims. A representation cannot be unwittingly given, least of all a representation that late claims will continue to be accepted unless and until prior notice is given to the contrary."

79. But he held that that was not fatal to Unilever's claim. He focused on two elements which he considered distinguished the case from *MFK* and justified the court, wholly exceptionally as he recognised, adopting a more flexible approach to what constitutes vitiating unfairness than was suggested by that case. The first was the clear and consistent pattern of Unilever's claims being invariably allowed in the past irrespective of whether they were in time or late. The second was the 'demonstrable pointlessness' of imposing a two-year time limit on the particular facts of this case; strict compliance with the two year time limit would have involved nothing 'other than the pedantic observance of an arid technicality utterly devoid of advantage to anyone'.

80. One final authority needs to be mentioned here. The Privy Council in *Paponette v A-G of Trinidad & Tobago* [2010] UKPC 32; [2011] 3 WLR 219 ('*Paponette*') referred at paragraph [30] to comments of Dyson LJ in *R (Association of British Civilian Internees: Far East Region) v Secretary of State for Defence* [2003] EWCA Civ 473, [2003] QB 1397 and stated that when considering whether the statement relied on is sufficiently clear and unambiguous the question is how, on a fair reading, the promise would have been reasonably understood by those to whom it was made.

81. We turn now to applying those principles to the facts of this case. The context in which the 4 August letter was sent is important. It followed on from Telefonica's letters of 27 March and 16 June. The 27 March 2008 letter did not include any request for a ruling on future treatment of the VAT adjustment for the line rental. It simply claimed the refund of past VAT paid, setting out the reasons why Telefonica argued that such a refund was justified and explaining the Revenue Methodology. There was nothing in that letter that would have alerted HMRC to the suggestion that Telefonica was seeking an assurance that it would be entitled to apply the Revenue Methodology for years into the future. The 16 June letter was also largely concerned with explaining what Telefonica had done for the previous VAT period and intended

to do for the forthcoming periods. The only references to the longer term future were second sentence of the letter, which stated that the letter 'set[s] out below [Telefonica's] proposed methodology for the calculation of output VAT adjustments for the first quarter of 2008 and beyond' and the factual statement that Telefonica would ‘continue to replicate this process for future years subject to any adjustment that may be necessitated by changes in law or business practice’. Again there was nothing there to suggest that Telefonica would interpret a confirmation of that fact as a promise on the part of HMRC to allow them to do so indefinitely subject only to changes in law or business practice.

82. In particular we consider it is important that Telefonica did not put forward at any stage any reason why it needed any such assurance. On the contrary, Telefonica had expressly told HMRC in the 2 May 2008 letter that it would not be changing its tariffs in reliance on the acceptance of the Revenue Methodology but would be absorbing the VAT saving as additional income. So there was nothing in the previous correspondence to indicate to HMRC that Telefonica wanted or needed an indication from HMRC as to continued acceptance of the Revenue Methodology.

83. The 4 August letter referred to the future application of the Revenue Methodology in two places. It said that it was acceptable to HMRC for making the adjustments for future returns “in 2008 and beyond.” It also repeated the phrase used in the 16 June letter that the methodology would be applied to all the VAT adjustments “unless it becomes necessary to make changes to the methodology due to changes in law or the business”.

84. Ms Simor contended that the phrase “changes in law or business” was wholly unclear. We do not accept that argument – taken by itself the phrase is sufficiently clear. But we agree with HMRC’s submission that in the context of the correspondence, the 4 August letter could not reasonably have been understood by Telefonica to be an unqualified assurance that it could use the Revenue Methodology forever as long as there was no material change in the law or its business. No reasonable person would conclude that HMRC was giving such an open-ended assurance despite not being asked for any assurance and despite no reason being presented as to why such an assurance was needed by the taxpayer.

85. We also conclude that no reasonable person would treat the fact that the 4 August letter acknowledged Telefonica’s intention to continue using the Revenue Methodology and that the writer echoed the wording used in the 16 June letter by referring to changes in the law or in business practice as indicating that HMRC was propounding some policy or promulgating guidance of a kind that would bind it to such an acceptance for the future.

86. We also reject Telefonica’s assertion that the subsequent practice of HMRC in accepting their VAT returns based on the Revenue Methodology between 2008 and 2013 ‘reinforced’ a legitimate expectation that the practice would continue indefinitely or that the absence over a few years of any challenge to it even after Mr Carlin’s audit generates some legitimate expectation. This situation is different from the situation in *Unilever*. HMRC here is not attempting to claw back VAT by

retrospectively applying the Usage Methodology to accounting periods for which they have accepted that it applied. Also the change of policy which Telefonica is attempting to override does not relate merely to a procedural time limit but to the application of provisions determining when tax is payable – the change of policy is not pointless or arid.

87. Our conclusion that there is no clear or unambiguous assurance given here is supported by the fact that the correspondence shows that Telefonica did not regard the Revenue Methodology as immutable. In its letter of 2 September 2010, Telefonica proposed certain adjustments to the calculations used in the Revenue Methodology which were subsequently audited by HMRC. That was not a wholesale change of methodology but it did indicate in our view that neither Telefonica nor HMRC regarded the Revenue Methodology as fixed and unchanging. Even after HMRC raised the issue of changing from the Revenue Methodology to a Usage Methodology at the meeting with Telefonica on 20 February 2014, it appears from the minutes that Telefonica agreed to review the Revenue Methodology and "consider whether it should now be revised given the changes in technology and also the way that people made use of their phones outside the EU" and then speak to HMRC to agree a way forward. At that meeting, it appears from the minutes that Telefonica was prepared to discuss ways to define usage other than revenue, such as voice minutes, number of texts or volume of data.

88. Our decision on this point is not affected by the fact, which was not disputed, that HMRC specified an end date for the use of agreed methodologies in agreements with some other telecommunications providers but not in the case of Telefonica. We did not have any evidence that Telefonica was aware in August 2008 that HMRC had set an end date for others but it seems to us that this fact does not alter our assessment of Telefonica's understanding of the agreement with HMRC. It certainly does not support any suggestion that HMRC might have agreed an arrangement with Telefonica which was not susceptible to change.

89. Given our decision, it is not necessary for us to consider Ms Simor's alternative submission that Telefonica was not entitled to rely on HMRC's alleged assurance because Telefonica misled HMRC when setting out the basis on which it charged customers for the line rental in 2008. Ms Simor alleged that Telefonica had misled HMRC when it said, in the letter dated 2 May 2008, that Telefonica's "sales are simply stated as a VAT inclusive retail price". This was an important point in relation to the need for Telefonica to show HMRC that it would not be unjustly enriched by a refund of the overpaid VAT because it had not passed on the unwarranted VAT in its charges to its customers. We accept therefore that the question whether the tariff charges were VAT inclusive or not was material to the overall question whether HMRC would accept that past overpayments of VAT should be refunded. Ms Simor contended that the bills issued to customers showed that Telefonica charged VAT in addition to the fixed monthly charge. Ms Simor's case was that the fact that the bills itemised VAT meant that the monthly charge was not a VAT inclusive charge. Accordingly, Telefonica had failed to "put all its cards face upwards on the table" as required by *MFK* for an enforceable legitimate expectation to arise.

90. We do not accept this submission and, had it been necessary to do so, we would have found that Telefonica did not mislead HMRC. Marketing material produced by Telefonica offered customers a choice of packages providing different levels of inclusive calls, texts and data each month for different monthly payments. The marketing material referred to the monthly payments as the "total cost" without any reference to VAT being charged in addition. Clause 1.1(d) of the terms and conditions for the Pay Monthly Tariff provided that "all prices shown include VAT, unless otherwise stated". The same terms and conditions also provided that calls outside the inclusive allowance are charged excluding VAT. The bills issued by Telefonica to customers showed VAT, as VAT invoices are required to do, but the VAT was included in the total monthly charge. In our judgment, the fact that the VAT is shown separately on the bill does not mean that the monthly amount stated in the marketing material and terms and conditions as payable by the customer is not a VAT inclusive price.

91. Further, the fact that Telefonica reserved the right in its contractual terms to increase the monthly amount if the rate of VAT increased does not affect our conclusion. The right to increase the monthly charge where there is an increase in VAT does not mean that the charge was exclusive of VAT, only that the VAT inclusive amount could be increased. Further, we consider that HMRC were or should have been aware that Telefonica showed VAT on bills issued to its customers. In the letter dated 2 May 2008, Telefonica said that if HMRC agreed that part of the monthly flat fee should be treated as outside the scope of UK VAT the monthly payment would remain the same because the "amount [of] VAT over declared within each monthly charge is, in any event, too small to sensibly be removed from tariff pricing".

92. If we are wrong in concluding that there was no clear and unambiguous assurance given by HMRC that Telefonica could use the Revenue Methodology, we would hold that HMRC was justified in resiling from any such assurance now. The leading case on when a public authority is entitle to frustrate a legitimate expectation is *R v North and East Devon Health Authority, Ex p Coughlan* [2001] QB 213. Lord Woolf MR, giving the judgment of the Court of Appeal said, at para 57:

> "Where the court considers that a lawful promise or practice has induced a legitimate expectation of a *benefit which is substantive*, not simply procedural, authority now establishes that here too the court will in a proper case decide whether to frustrate the expectation is so unfair that to take a new and different course will amount to an abuse of power. Here, 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."

93. Mr Grodzinski submitted, relying on paragraphs 36 to 38 of *Paponette,* that once a claimant has established that a legitimate expectation exists then, in a claim based on a promise, the burden shifts to the public authority to show that its decision to resile from the promise is objectively justified in the public interest and as proportionate in the circumstances of the case. Mr Grodzinski contended that HMRC had not discharged that burden. Ms Simor submitted that if there was a departure from any

legitimate expectation held by Telefonica, which HMRC did not accept, then it was justified in all the circumstances. She gave two reasons. First, if the Revenue Methodology is assumed to be unlawful then it cannot be unlawful for HMRC to require Telefonica to use the Usage Methodology. While the logic of that submission is clearly right, we have held that we are not required to assume that the Revenue Methodology is unlawful but only that the Usage Methodology is not unlawful.

94. The main justification given by HMRC for resiling from the promise, if such a promise had been given was that changes in technology now allowed Telefonica to collect the data necessary for the Usage Methodology and that methodology would lead to additional tax being collected. While accepting that there had been changes in technology, Telefonica did not accept that it was in a position to capture the data necessary to implement the Usage Methodology. We must, however, assume that the Usage Methodology is the appropriate methodology and that implies that it is possible for Telefonica to implement it otherwise it could not be the appropriate methodology.

95. On that basis, we consider that requiring Telefonica to use a more accurate way of apportioning the monthly charge between EU and non-EU telecommunications services serves an overriding public interest in the proper collection of taxes. It can be objectively justified because it better reflects the place of supply rules in the PVD and VATA94 and, in addition, results in the correct amount of tax, calculated by reference to those rules being paid.

96. This leads us to the issue of detriment which the authorities make clear is a relevant factor in determining whether it is an abuse of power for a public authority to resile from an assurance it has given. This issue was dealt with in the evidence of Ms Gething for Telefonica. It appears from her evidence that the only consequence of HMRC's acceptance of the Revenue Methodology was that, as one would expect, Telefonica began to factor the VAT adjustment into its annual budgeting process. Telefonica's evidence was that it had assumed for the purposes of its budget for 2015 that it would receive about £11 million additional income as a result of using the Revenue Methodology. This would be reduced to about £150,000 to £350,000 if the Usage Methodology was adopted. Ms Gething states that this unexpected reduction in income will result in a shortfall in Telefonica's business budget, possibly leading to reduced capital expenditure, lower investment and less innovation within the UK consumer market.

97. We view these assertions with some scepticism. The figures that Telefonica provided to HMRC when describing the Revenue Methodology in March 2008 show that the expected annual income from line rental was £211.5 million. That line rental, as we have described, is only one element in the monthly charge to tariff customers; that monthly charge is only one element of the overall payments made by tariff customers and those tariff customers are only part of the total population of Telefonica mobile phone customers since pay as you go customers are not included in those figures. Given the huge scale of Telefonica's business, we reject the suggestion that a budget shortfall of £11 million will have any impact on innovation in the mobile phone market in this country.

98. We do not consider that there is any material reliance by Telefonica or corresponding detriment to them which overrides the public interest in HMRC being able to require Telefonica to adopt what HMRC considers to be a better and more accurate methodology for making this adjustment. An additional point is that, as mentioned earlier, other mobile phone companies were expressly given a date on which their ability to adopt the Revenue Methodology would be reviewed. Those companies must now be moving to the Usage Methodology. We consider that there is a public interest in these companies being treated equally as regards this VAT adjustment. The assurance, if it had been given, would not in our judgment justify a continuing preferential treatment of Telefonica over its rivals.

99. We therefore hold that there was no legitimate explanation generated either by the 4 August letter or by the acceptance of the Revenue Methodology over a number of years. There is no unfairness or abuse of power in HMRC now changing the way that the VAT adjustment is calculated.

Was there a breach of Telefonica's procedural legitimate expectations?

100. In summary, Telefonica's case is that the agreement that it could use the Revenue Methodology had been in place since 2008 and that gave rise to a duty on HMRC properly to consult Telefonica before requiring it to change to the Usage Methodology. In response, HMRC submitted that there is no duty to consult and, if there were, they consulted adequately. In reply, Telefonica submitted that, even if there were no duty to consult, once a public authority has decided to engage in some consultation, they must do it properly which meant allowing Telefonica to make representations and explain why it could not implement the new methodology and that had not happened in this case.

101. As to when the duty to consult arises, Mr Grodzinski referred to the Court of Appeal's decision in *R (on the application of Bhatt Murphy (a firm) and others) v Independent Assessor; R (on the application of Niazi and others) v Secretary of State* [2008] EWCA Civ 755 ('*Bhatt Murphy*'). Laws LJ gave a broad summary of the place of legitimate expectations in public law with particular reference to when the duty to consult arises [50] as follows (emphasis added):

> "The power of public authorities to change policy is constrained by the legal duty to be fair (and other constraints which the law imposes). A change of policy which would otherwise be legally unexceptionable may be held unfair by reason of prior action, or inaction, by the authority. If it has distinctly promised to consult those affected or potentially affected, then ordinarily it must consult (the paradigm case of procedural expectation). If it has distinctly promised to preserve existing policy for a specific person or group who would be substantially affected by the change, then ordinarily it must keep its promise (substantive expectation). **If, without any promise, it has established a policy distinctly and substantially affecting a specific person or group who in the circumstances was in reason entitled to rely on its continuance and did so, then ordinarily it must consult before effecting any change (the secondary case of procedural expectation)**. To do otherwise, in any of these instances, would be to act so unfairly as to perpetrate an abuse of power."

102. That summary should be read in the light of Laws LJ's more detailed comment in [49] that:

> "I apprehend that the secondary case of legitimate expectation [ie procedural expectation] will not often be established. Where there has been no assurance either of consultation (the paradigm case of procedural expectation) or as to the continuance of the policy (substantive expectation), there will generally be nothing in the case save a decision by the authority in question to effect a change in its approach to one or more of its functions. And generally, there can be no objection to that, for it involves no abuse of power. Here is Lord Woolf again in *Ex p Coughlan* (paragraph 66):
>
>> 'In the ordinary case there is no space for intervention on grounds of abuse of power once a rational decision directed to a proper purpose has been reached by lawful process.'
>
> Accordingly for this secondary case of procedural expectation to run, the impact of the authority's past conduct on potentially affected persons must, again, be pressing and focussed. One would expect at least to find an individual or group who in reason have substantial grounds to expect that the substance of the relevant policy will continue to enure for their particular benefit: not necessarily for ever, but at least for a reasonable period, to provide a cushion against the change. In such a case the change cannot lawfully be made, certainly not made abruptly, unless the authority notify and consult."

103. Mr Grodzinski also referred to the decision of the Privy Council in *Rainbow Insurance Company Ltd v The Financial Services Commission & Ors (Mauritius)* [2015] UKPC 15. Having cited Laws LJ's formulation of a "secondary case of procedural expectation" in *Bhatt Murphy* (set out above), the Privy Council observed at paragraph 51:

> "Laws LJ in formulating this expectation was considering unusual circumstances where, absent a representation that the policy would continue, an abrupt change of policy was held to be so unfair as to amount to an abuse of power. A classic example is *R v Inland Revenue Commissioners, Ex p Unilever plc* [1996] STC 681. In that case the Inland Revenue Commissioners on thirty occasions over twenty years had exercised their lawful discretion to entertain late claims for loss relief against corporation tax and then suddenly, without notice or consultation and for no good reason, refused such claims as out of time. The Board does not need to address questions of taxonomy by deciding whether this is a separate head of legitimate expectation or whether it is a particular example of what Lord Fraser described as an established practice which the claimant could reasonably expect to continue. It is enough to observe that there are cases in which fairness requires that a change in policy cannot be made abruptly because it would defeat the legitimate expectations of an individual or group. In such cases, as Sedley LJ stated in [*Bhatt Murphy*] at para 70, it is not the alteration of the policy but the way in which it is done which is capable of frustrating a legitimate substantive right expectation."

104. In relation to the duty to consult, Telefonica relied on the 'Sedley criteria' endorsed by the Supreme Court in *R (on the application of Moseley) v London Borough of Haringey* [2014] UKSC 56, [2014] 1 WLR 3947. Lord Wilson (with whom Lord Kerr agreed) summarised the common law approach in [23] – [26]:

"23. A public authority's duty to consult those interested before taking a decision can arise in a variety of ways. Most commonly, as here, the duty is generated by statute. Not infrequently, however, it is generated by the duty cast by the common law upon a public authority to act fairly. The search for the demands of fairness in this context is often illumined by the doctrine of legitimate expectation; such was the source, for example, of its duty to consult the residents of a care home for the elderly before deciding whether to close it in *R v Devon County Council, ex parte Baker* [1995] 1 All ER 73. But irrespective of how the duty to consult has been generated, that same common law duty of procedural fairness will inform the manner in which the consultation should be conducted.

…

25. In *R v Brent London Borough Council, ex p Gunning*, (1985) 84 LGR 168 Hodgson J quashed Brent's decision to close two schools on the ground that the manner of its prior consultation, particularly with the parents, had been unlawful. He said at p 189:

> 'Mr Sedley submits that these basic requirements are essential if the consultation process is to have a sensible content. First, that consultation must be at a time when proposals are still at a formative stage. Second, that the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response. Third, … that adequate time must be given for consideration and response and, finally, fourth, that the product of consultation must be conscientiously taken into account in finalising any statutory proposals.'

Clearly Hodgson J accepted Mr Sedley's submission. It is hard to see how any of his four suggested requirements could be rejected or indeed improved. The Court of Appeal expressly endorsed them, first in the *Baker* case, cited above (see pp 91 and 87), and then in *R v North and East Devon Health Authority, ex parte Coughlan* [2001] QB 213 at para 108. In the *Coughlan* case, which concerned the closure of a home for the disabled, the Court of Appeal, in a judgment delivered by Lord Woolf MR, elaborated at para 112:

> 'It has to be remembered that consultation is not litigation: the consulting authority is not required to publicise every submission it receives or (absent some statutory obligation) to disclose all its advice. Its obligation is to let those who have a potential interest in the subject matter know in clear terms what the proposal is and exactly why it is under positive consideration, telling them enough (which may be a good deal) to enable them to make an intelligent response. The obligation, although it may be quite onerous, goes no further than this.'

The time has come for this court also to endorse the Sedley criteria. They are, as the Court of Appeal said in *R (Royal Brompton and Harefield NHS Foundation Trust) v Joint Committee of Primary Care Trusts* [2012] EWCA Civ 472, 126 BMLR 134, at para 9, 'a prescription for fairness'.

26. Two further general points emerge from the authorities. First, the degree of specificity with which, in fairness, the public authority should conduct its consultation exercise may be influenced by the identity of those whom it is consulting. Thus, for example, local authorities who were consulted about the government's proposed designation of Stevenage as a 'new town' (*Fletcher v Minister of Town and Country Planning* [1947] 2 All ER 496 at p 501) would be

> likely to be able to respond satisfactorily to a presentation of less specificity than would members of the public, particularly perhaps the economically disadvantaged. Second, in the words of Simon Brown LJ in the *Baker* case, at p 91, 'the demands of fairness are likely to be somewhat higher when an authority contemplates depriving someone of an existing benefit or advantage than when the claimant is a bare applicant for a future benefit'."

105. At [35] of *Moseley*, Lord Reed observed:

> "The common law imposes a general duty of procedural fairness upon public authorities exercising a wide range of functions which affect the interests of individuals, but the content of that duty varies almost infinitely depending upon the circumstances. There is however no general common law duty to consult persons who may be affected by a measure before it is adopted. The reasons for the absence of such a duty were explained by Sedley LJ in *R (BAPIO Action Ltd) v Secretary of State for the Home Department* [2007] EWCA Civ 1139; [2008] ACD 20, paras 43-47. A duty of consultation will however exist in circumstances where there is a legitimate expectation of such consultation, usually arising from an interest which is held to be sufficient to found such an expectation, or from some promise or practice of consultation. The general approach of the common law is illustrated by the cases of *R v Devon County Council, Ex p Baker* [1995] 1 All ER 73 and *R v North and East Devon Health Authority, Ex p Coughlan* [2001] QB 213, cited by Lord Wilson, with which the *BAPIO* case might be contrasted."

106. It was common ground that there is no statutory duty to consult in this case. Mr Grodzinski submitted that there was a common law duty to consult in this case because of HMRC's acceptance of the Revenue Methodology in 2008 and the impact on Telefonica's IT systems. Mr Grodzinski submitted that Telefonica had reason to believe that the methodology would continue to enure for its benefit after the exchange of correspondence in 2008 and the 2010 audit. That gave rise to a duty on HMRC to consult Telefonica before depriving it of the benefit of being able to use the Revenue Methodology. He further submitted that it is not correct that, as HMRC contend, there is no duty to consult unless there is an abrupt change.

107. Mr Grodzinski further contended that, once a public authority has purported to consult, it must do so properly. He referred to Lord Woolf's comments in *Ex p Coughlan* at [108]:

> "It is common ground that whether or not consultation of interested parties and the public is a legal requirement, if it is embarked upon it must be carried out properly. To be proper, consultation must be undertaken at a time when proposals are still at a formative stage; it must include sufficient reasons for particular proposals to allow those consulted to give intelligent consideration and an intelligent response; adequate time must be given for this purpose; and the product of consultation must be conscientiously taken into account when the ultimate decision is taken".

108. Mr Grodzinski submitted that the consultation was not conducted properly while the proposals were at a formative stage and HMRC did not give Telefonica sufficient opportunity to make representations on the unlawful and impractical nature of the proposals. He said that HMRC had not filed any evidence suggesting that they

had taken these matters into account. Mr Grodzinski submitted that the whole point of consultation is to give the consultee an opportunity to explain and that HMRC had ignored requests by Ernst & Young for a meeting to discuss the issues and engage in meaningful consultation in accordance with the Sedley criteria.

109. HMRC rely on the meeting on 8 December 2014 to show that they did engage in some consultation but Mr Grodzinski submitted that this was not a consultation but the presentation of a decision that had already been taken. Telefonica's PAP letter written in December 2014 prompted HMRC to extend the deadline for implementing the Usage Methodology from 1 January 2015 to 31 March but there was no consultation or review of the decision. HMRC gave no explanation why the extension to the end of March 2015 was sufficient to allow Telefonica to change IT systems to provide the information necessary to implement the Usage Methodology. Mr Grodzinski submitted that the duty of consultation had been breached and invited us to quash the decision of November 2014 so that HMRC can consult properly.

110. Ms Simor relied on passages from *Rainbow Insurance* which, following Lord Reed in *Moseley* at [35], stated that there is no general common law duty on a public body to consult persons who may be affected by a measure before it is adopted. In addition, she relied on *R (on the application of Cheshire East Borough Council and another) v Secretary of State for Environment Food and Rural Affairs* [2011] EWHC 1975 (Admin) at [57] as authority for the proposition that, in the absence of legitimate expectation of consultation created by an express promise or an established practice, a duty to consult will only arise in exceptional circumstances. In any event, Ms Simor contended, HMRC did consult Telefonica adequately about the proposed change in methodology.

111. As Lord Reed stated in *Moseley*, there is no general common law duty to consult persons who may be affected by a measure before it is adopted but such a duty may exist where a promise or practice has created a legitimate expectation of consultation. Even where there is no such expectation, there may be a duty to consult where an abrupt change of policy would be so unfair as to amount to an abuse of power. The *Unilever* case is an example of such a case. In *Unilever,* a duty to consult existed notwithstanding the absence of a legitimate expectation of consultation because a change of policy or practice without consultation was held to be so unfair as to amount to an abuse of power. Such cases are exceptional (see *Rainbow Insurance* at paragraph 51) and we do not consider that Telefonica's situation is analogous to that of Unilever. In *Unilever*, the refusal to entertain late claims for loss relief was made suddenly, without notice or consultation and for no good reason. Unlike in *Unilever,* HMRC provided Telefonica with advance notice of the change, the reason for it and gave Telefonica some opportunity to respond. We do not consider that HMRC's actions in this case can be described as an abuse of power.

112. Notwithstanding our view that this is not a *Unilever* type case, we consider that HMRC had a duty to consult Telefonica about the proposed change to the agreed methodology for calculating the effective use and enjoyment of the telecommunications services outside the EU. We reach that view for the reasons given by Laws LJ in *Bhatt Murphy* and Lord Reed in *Moseley*. HMRC's acceptance

of the use of the Revenue Methodology distinctly and substantially affected Telefonica which had grounds to expect that it would be able to continue to use the methodology, not necessarily for ever, but at least for a reasonable period. The use of the Revenue Methodology conferred a benefit on Telefonica of several million pounds each year in the form of relief from payment of VAT. HMRC would have been aware of the benefit to Telefonica from the initial repayment claim in 2008 and the audit of the methodology in 2010. In our view, that financial benefit gave Telefonica sufficient interest to found a legitimate expectation that HMRC would not require Telefonica to use another methodology, substantially reducing that benefit, without consultation. We consider that Telefonica was entitled to expect that HMRC would not change the established practice and simply require a change in methodology without some discussion and an attempt to reach agreement. It appears to us that HMRC shared that view as is apparent from the minutes of the meeting and subsequent correspondence in 2013 and 2014.

113. Even if we are wrong and HMRC did not have any duty to consult, we accept Mr Grodzinski's submission, founded on *Coughlan*, that where a public authority has started to consult then it must do so properly. In this case, HMRC engaged in meetings and correspondence with a view to discussing changes in the methodology and we did not understand it to be part of HMRC's case that they did not purport to consult Telefonica. Indeed, Ms Simor's submission was that, if there was a duty to consult, which was denied, then HMRC discharged it properly.

114. The Sedley criteria ensure that the consultation is carried out in accordance with the public authority's common law duty of procedural fairness. Lord Wilson's comments in [26] of *Moseley* show that the way in which the duty to consult must be discharged may vary according to the characteristics of the consultee, the nature of the decision and its effect on the consultee. Whether there was adequate consultation in accordance with the Sedley criteria is a question of factual analysis.

115. In our view, HMRC did consult properly in that they provided Telefonica with an adequate opportunity to make representations and explain why they could not implement the Usage Methodology. We consider that the consultation process should be regarded as having started in 2013 when HMRC first raised concerns about the Revenue Methodology that had been used by Telefonica for broadband services on the ground that it relied on estimation rather than use. The concerns were at an early stage but HMRC clarified their concerns about the Revenue Methodology and indicated that they wanted Telefonica to change to a methodology based on use in the letter of 3 July 2013. HMRC's views in relation to mobile phone services were further explained at the meeting on 20 February 2014 when Telefonica was asked to consider changes to the methodology and to agree a way forward with HMRC. The correspondence that followed the meeting repeated the desire on HMRC's part to agree a revised methodology. In our view, whether the consultation is regarded as having begun in 2013 or 2014, it was at a time when proposals were still at a formative stage. In the meetings and correspondence that followed, we consider that HMRC provided sufficient reasons for the proposed change in methodology to enable Telefonica to consider the proposal and respond. Indeed, Telefonica did respond with "an open mind" in an email to HMRC on 14 April 2014 which attached the Vodafone

letter that reflected Telefonica's view that a usage based methodology would be very complex. Following the April 2014 letter, Ernst & Young became involved and Telefonica appears to have been content to leave representations to be made by Ernst & Young on behalf of the industry generally. Unfortunately, those came to nothing and no meeting took place before HMRC issued the November Position Paper. There was, however, a meeting between HMRC and members of the telecommunications industry, including Telefonica, in December 2014. Telefonica's case is that the decision had already been taken but we consider that HMRC were still open to representations as is made clear by the note that they sent to Telefonica on 19 December. This showed that they proposed to update the November Position Paper as they did although that was only to extend the period for implementation. It is unfortunate, perhaps, that Telefonica did not make proposals and no meeting was organised with Ernst & Young before the November position paper. In our view, that fact does not mean that the Sedley criteria were not satisfied. Telefonica was aware and also partly at fault in relying solely on Ernst & Young rather than taking the initiative and making its representations. In our view, there was adequate consultation.

Decision on the judicial review

116. For the reasons given above, we dismiss Telefonica's claim.

Costs

117. Any application for costs must be made within one month after the date of release of this decision. As any order in respect of costs will be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 40 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

The Hon Mrs Justice Rose DBE
Chamber President

Judge Greg Sinfield

Judge of the Upper Tribunal

Release date: 15 April 2016