The three stages

Management of taxes

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Keith Gordon looks at a case which considers when a contract settlement with HMRC is formally concluded

Key Points

What is the issue?

A basic grasp of contract law is essential to any tax practitioner as the existence or absence of a contract can be determinative of many tax questions, ranging from

capital gains tax to VAT.

What does it mean to me?

In cases where a contract is thought to have been reached, it will make sense to use this case as an opportunity to review the paperwork to check that the same conclusion would be reached by an objective reader.

What can I take away?

The case emphasises the importance of considering carefully the wording of discussions with HMRC so that a contractual agreement is reached whenever intended – and not when not.

The late Leo Price QC was once appearing before the judicial committee of the House of Lords (the predecessor to the Supreme Court). He opened his submissions as follows: ‘My Lords: under English law, there are three components to a valid contract: an offer, acceptance and consideration.’ The five judges looked at Mr Price suspiciously before one interjected, ‘I think you can assume that this Court is familiar with the basics of contract law.’ Without hesitation, Mr Price responded, ‘That was the mistake I made before the Court of Appeal.’

A basic grasp of contract law is essential to any tax practitioner as the existence or absence of a contract can be determinative of many tax questions, ranging from capital gains tax to VAT. Furthermore, whilst most of the articles I write consider disputes which follow a formal determination or assessment for tax, it should be remembered that many tax disputes are resolved by way of a contract settlement. The recent case of *Kyte v HMRC* [2018 EWHC 1146 (Ch) concerns discussions with such a contract settlement in mind.

Facts of the case

In the 2007/08 tax year, Mr Kyte had participated in what I shall describe neutrally as a film scheme. I express no opinion as to whether the arrangements were tax-motivated or simply made more attractive by the potential tax reliefs available to investors. Nevertheless, as a result of the arrangements, Mr Kyte claimed a significant trading loss in the 2007/08 tax year which he sought to set off against other income of the year. More modest trading losses were claimed in subsequent

tax years.

An enquiry was opened into the 2007/08 return (and also into returns for the 2008/09, 2010/11, 2011/12 and 2012/13 tax years). As yet, none of these enquiries has been closed. Nevertheless, in about 2013, Mr Kyte's advisers and HMRC embarked on a course of correspondence with a view to the parties reaching a possible settlement.

In the course of this correspondence, HMRC wrote to Mr Kyte on 4 January 2016 with calculations identifying how much additional tax HMRC expected Mr Kyte to pay for each of the years in question. The additional tax and interest came to £316,955.30.

My Kyte's advisers responded the following week (12 January 2016) confirming that Mr Kyte wished to proceed with the settlement on those terms and asked HMRC for a settlement deed. They also asked whether it would be acceptable for Mr Kyte to pay the additional £316,955.30 over a nine-month period.

This response was acknowledged the next day with a comment that the proposed instalment arrangement would affect the wording of any settlement deed. However, the critical event took place on 28 January 2016 when HMRC announced that they had discovered an error in their figures as provided on 12 January. This announcement led to Mr Kyte's advisers asserting that a binding agreement had already been reached. As this was not accepted by HMRC, Mr Kyte applied to the High Court for a declaration that a binding contract had been entered into on 12 January 2016 (by the advisers' acceptance of HMRC's earlier offer on Mr Kyte's behalf) and that the subsequent payment of the £316,955.30 has therefore satisfied Mr Kyte's relevant tax liabilities.

The High Court's decision

The case was heard by Chief Master Marsh. (A Master is, effectively, a junior judge within the Royal Courts of Justice.) His judgment summarised the key legal principles, which were largely agreed by the parties. In particular, it was agreed that the concept of offer and acceptance should be interpreted objectively rather than by reference to the subjective intentions of either of the parties. They should also be viewed in their context.

He cited one recent High Court case which noted that vagueness in what is said or the omission of an important term might be grounds for concluding that either there

has been no agreement or that what has been agreed is not intended to be legally binding. However, that same authority continued to note that, where an agreement has been reached by the parties, the courts are generally reluctant to conclude that the agreement is too uncertain to be of contractual effect – such a conclusion is very much a last resort.

Chief Master Marsh supplemented this principle with a couple of observations of his own. First, he considered that the courts will generally take a pragmatic approach to filling in gaps in the contract when it is clear that the parties intended to enter into a contract. Secondly, he added that the context includes any special features that attach to one or both of the parties. In the context of HMRC, he noted that it operates within a highly complex statutory framework and with statutory duties to collect tax. (He did not consider that HMRC's statutory role would be a significant feature in the context of commercial agreements that HMRC might reach, for example in relation to its buildings or the supply of goods or services.) Notwithstanding those special features, however, Chief Master Marsh accepted that the law of contract applies to agreements to settle a tax liability in the same way as any other agreement.

The Master also noted that the technical and rigid concepts of offer and acceptance (etc.) will often require a court to take a flexible (the Master said 'practical') approach so as to force real-life facts into the straitjackets of offers, acceptance and consideration.

Reviewing the facts, the Master noted that the correspondence started relatively informally although formality definitely increased in the latter half of 2015. Nevertheless, considering the correspondence in the round, the Master considered that the 4 January letter put forward 'computations' rather than any formal settlement offer. The letter was simply the next iteration of the calculations that had preceded it. Although, unlike their predecessors, the figures were not headed with 'indicative', the Master considered that the discussions were still some way short of any formal contractual status. As a result, the Master concluded that there had been no offer.

Consequently, there was no need to consider the remaining objections put forward by HMRC to Mr Kyte's claim. Nevertheless, the Master addressed them in the alternative.

He considered that the 12 January response could not amount to an acceptance. First, the terminology used by the adviser – that Mr Kyte 'would like to go ahead' – was considered too equivocal. Secondly, Mr Kyte requested a settlement deed, suggesting that he considered matters still be to 'subject to contract'. Thirdly, there remained one unresolved matter – the payment date(s), which the Master considered to be an essential part of an offer to pay a sum of money. The Master accepted that terms can sometimes be implied so as to fill a gap. However, in the circumstances, the Master considered that the gap was too wide to be filled. Accordingly, even if HMRC could be said to have made an offer on 4 January, the response on 12 January was not an acceptance of that offer; if anything, it amounted to a counter-offer.

The Chief Master also accepted two other arguments put forward by HMRC which overlap with the previous two issues: he considered that there was a lack of the legal certainty needed to conclude a contract. For example, although the 4 January computations had calculated interest until 31 January 2016, it was not clear that that constituted a contractual payment date and was instead one identified for the sake of convenience. It was also not entirely clear what liabilities were being resolved through the proposed agreement.

Commentary

Although I think that it might have been possible for a different conclusion to have been reached on the status of the 4 January 2016 letter, I am not suggesting that the Chief Master's decision was not also a reasonable one to reach. Nevertheless, it is hard to disagree with the Chief Master's overall decision, especially in view of the open-ended nature of Mr Kyte's advisers' response of 12 January.

The case therefore emphasises the importance of considering carefully the wording of discussions with HMRC so that a contractual agreement is reached whenever intended – and not when not. In the present case, I do not suppose that there had been any actual intention to treat the 12 January response as an acceptance until it was later realised that it might be beneficial to do so. (However, as previously noted, the parties' intentions are not determinative of the issue as to whether a contract has been formed.)

Finally, it is noteworthy that the Chief Master commented that there was no reason why HMRC cannot put forward an offer, which the taxpayer later accepts. However,

advisers will recognise that HMRC generally insist upon any offer emanating from the taxpayer. Nevertheless, this shows that (provided that the facts support the contention) a court will not be precluded from finding that a contract has been formed by the taxpayer accepting an offer made by HMRC.

What to do next

In cases where a contract is thought to have been reached, it will make sense to use this case as an opportunity to review the paperwork to check that the same conclusion would be reached by an objective reader. Of course, any party seeking to resile from any such agreement would also benefit from a review, in case it can be argued that a critical component of a binding contract is missing. Different issues might arise if you are dealing with a case governed by Scots or Irish law.

In the meantime, always remember those keys ingredients of a contract – even if (as was alleged) the Court of Appeal did not.