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RESOLVING DISPUTES WITH HMRC

This is the eighth in our series of ADR practical guides, designed to provide clients with practical guidance on various processes falling under the banner of "alternative dispute resolution" (ADR), with a particular focus on mediation.

This guide provides a brief description of how and when ADR can be used to seek to resolve disputes with the UK tax authority, HMRC.

USE OF ADR BY HMRC

His Majesty's Revenue and Customs (HMRC) is a non-ministerial government department, responsible for the collection and management of tax in the UK. While HMRC has wide discretion in doing so, it has formulated and published a strategy regarding the resolution of disputes. That strategy paper, entitled HMRC's Litigation and Settlement Strategy (the LSS), was first published in 2007 and subsequently refreshed. The current version (together with detailed commentary) was published in October 2017. The LSS contemplates that HMRC may engage in ADR to support the resolution of disputes with taxpayers.

The procedural rules of the First-tier Tribunal (Tax Chamber) also require the Tribunal hearing a tax appeal to seek where appropriate: (i) to bring to the attention of the parties the availability of ADR; and (ii) to facilitate the use of ADR, if the parties wish to engage in it and if, in the circumstances, its use is compatible with the overriding objective of dealing with cases fairly and justly. In June 2020, the President of the Tax Chamber issued a practice statement on the Tribunal's approach to facilitating the use of ADR, underlining its commitment to the process, and its willingness to stay proceedings in order to allow parties to engage meaningfully in ADR.

ADVANTAGES OF ADR IN TAX DISPUTES

Many of the advantages commonly associated with ADR are equally applicable to ADR involving HMRC. Two of the most significant advantages in the context of a tax dispute are:

- confidentiality – particularly given the reputational risks faced by businesses in the context of public and political attitudes towards perceived "infringement" of the letter or spirit of the UK's tax legislation; and
- speed – even a well-managed tax appeal can take over 18 months from notification of the appeal (after a potentially lengthy investigation/enquiry) to reach a first instance hearing, whereas HMRC intends most mediations to take place within four months.

FORMS OF ADR WITH WHICH HMRC WILL ENGAGE

HMRC's formal ADR policy provides only for mediation. Informally, it may be possible (in suitable cases) to engineer a form of non-binding evaluation of expert determination or facilitated discussion.

The mediation will be conducted by an HMRC officer who has been professionally trained as a mediator and who is independent of the case team handling the dispute. In that way, they are intended to be impartial and neutral. You can elect to appoint another (professionally accredited) mediator of your own choosing (and at your own expense) to work alongside the HMRC mediator. However, HMRC's mediator will retain overall control of the mediation.

DISPUTES SUITABLE FOR ADR

As ADR is a consensual process, it will only be possible for you to engage with HMRC in ADR in cases where HMRC considers the dispute is suitable for ADR. HMRC's view is that ADR should only be considered where it is likely to add value and considers that it is unlikely to be appropriate unless the benefits can be clearly identified, articulated and agreed.

HMRC's published view is that ADR might be of benefit (and therefore might be appropriate) in cases where, for example:

- communications have broken down (and so a mediator may be able to help restore communications);
- there are disputes about facts (and so a mediator may be able to help ensure both parties can ask for, and clarify, matters and – where possible – reach an agreed position, at least as regards what facts are actually relevant);
- the dispute is the result of a misunderstanding (and so the mediator can assist in establishing whether HMRC actually needs the information it is asking for from the taxpayer); or
- the dispute concerns a technical point or a point of law (and so a mediator may be able to help the parties identify a range of possible answers, even where the case appears to be of a binary, "all or nothing" nature).

In general terms, HMRC considers ADR not to be suitable in cases where: (i) the customer does not want mediation; (ii) HMRC wishes to progress a "test case" in order to obtain a ruling on a disputed issue affecting a number of cases; or (iii) HMRC wishes to test the veracity or strength of the taxpayer's evidence by cross-examination.

In addition to these general cases, HMRC has published a list of specific cases in which it will not consider ADR. Those specific cases include:

- cases where HMRC suspects tax evasion;
- "straightforward" cases (such as those which have been categorised by the Tribunal as "paper" or "basic" cases); or
- where the application of an extra-statutory concession is in issue.

WHEN AND HOW THE ADR PROCESS IS STARTED

You can seek to engage in ADR with HMRC at any stage of a dispute, from the point at which an enquiry or investigation begins to the point at which HMRC makes a decision. However, ADR is most likely to be appropriate only once you and HMRC have had the opportunity to explore fully the relevant facts and your respective technical positions. Accordingly, ADR is usually unlikely to be appropriate during the early stages of an investigation or enquiry.

Once HMRC has made a decision (usually by way of an assessment), the rules differ as between cases involving direct tax (eg income tax and corporation tax) and indirect tax (eg VAT and customs duty). This is due to the slightly different appeal mechanics which apply in each case:

- Where HMRC has made a decision in a direct tax case, and you have appealed against that decision to HMRC, you can apply for ADR only where: (i) no statutory review of the decision has yet been offered by HMRC; or (ii) where you have notified your appeal to the Tribunal (following the offer, or completion, of a statutory review), and only once the Tribunal has acknowledged your appeal.
- Where HMRC has made a decision in an indirect tax case, you can apply for ADR only once you have notified an appeal against that decision to the Tribunal, and the Tribunal has acknowledged your appeal.

Engaging in ADR does not automatically stay any statutory appeal or case management deadlines (eg where litigation is in contemplation or has been commenced). Accordingly, if you wish to engage in ADR, you (and HMRC) should consider whether to agree/apply for a stay of procedural steps/proceedings or progress ADR in parallel with any litigation processes.

In order to apply for ADR at any stage where it is available, you need to complete HMRC's online application (available here). Once your application has been submitted, HMRC will assess whether the case is suitable for ADR in conjunction with the HMRC office with conduct of the relevant dispute. Usually, a decision will be made and communicated to you by HMRC within 30 days. If HMRC is minded to refuse your application for ADR, it will be further considered by HMRC's ADR Panel, in order to provide assurance that applications are properly assessed and that decisions are consistent and principled.

WITHOUT PREJUDICE DISCUSSIONS

It is important to understand that HMRC does not accept that the usual "without prejudice" rule applies in the context of HMRC mediations.

Specifically, HMRC takes the view that the without prejudice rule will not apply to any "tax fact" that is disclosed by you during the course of the mediation. The concept of a "tax fact" is an entirely novel invention on the part of HMRC and is said by HMRC to be "*a fact that has legal and technical implications for a [taxpayer's] tax liability [and is] not capable of being without prejudice*". HMRC gives the following as examples of a "tax fact":

- the receipt of a payment;
- the making of a supply;
- the place of a supply; and
- the identity of a customer.

It is disappointing that HMRC has opted to take this approach since it can lead to uncertainty and to a stifling of frank dialogue.

SETTLEMENT DECISION MAKING WITHIN HMRC

Any agreement reached by HMRC during an ADR process will need to be reached in accordance with HMRC's published Code of Governance for resolving tax disputes (which is available here). Accordingly, prior to attending a facilitated discussion or mediation, you should ensure that:

- the HMRC representatives attending have already engaged with the appropriate HMRC decision maker and obtained authorisation to settle within specified parameters (or that the relevant decision maker will be available during the facilitation/ mediation to approve any settlement); or
- if that is not practicable, that HMRC have put in place measures to ensure that any provisional settlement agreed during the process can be considered by the relevant HMRC decision maker on an expedited basis (eg by preparing the appropriate paperwork required by the decision maker, and agreeing a timetable for approval, in advance of the facilitation/mediation).

LIMITS OF WHAT HMRC CAN AGREE

The relevant HMRC decision maker will only approve a settlement reached in ADR if it complies with the LSS. The LSS provides that HMRC will only settle a dispute in accordance with the law – that is, on a basis that HMRC believes to be a likely outcome of any eventual litigation. There may be a range of likely outcomes, for example:

- There may be a number of technical issues (whether cumulative or alternative) which could give rise to a range of possible tax results depending on how they are determined by the Tribunal or Court.

- There may be a range of factual findings that a Tribunal or Court could make (in the absence of clear/agreed facts), giving rise to a range of possible tax results. (In the absence of full factual information, it is permissible in certain circumstances for HMRC to agree factual assumptions.)

Where there is a range of likely outcomes, HMRC will take account of which outcome secures the right tax most efficiently – in other words, HMRC may take account of factors such as: (i) the likely costs of pursuing their "best case scenario" through litigation; and (ii) the likely effect a proposed agreement would have on the taxpayer's (or other taxpayers') behaviour in future.

However, where there is no range of likely outcomes, ie the dispute is "all or nothing", HMRC will either: (i) settle for no less than 100% of the tax it considers due; or (ii) concede the issue in full.

Though HMRC may consider settling a number of disputes with you at the same time (and, in doing so, may settle them on different terms than it would if each dispute were settled separately), HMRC will not enter into undifferentiated "package deals" in which the merits of each dispute are not separately considered.

KEY CONTACTS

Alexander Oddy
Partner, Head of ADR
T +44 20 7466 2407
alexander.oddy@hsfkramer.com

Nick Clayton
Partner
T +44 20 7466 6409
nick.clayton@hsfkramer.com

Camilla Macpherson
Knowledge Lawyer
T +44 2031 392 782
camilla.macpherson@hsfkramer.com

For the latest ADR news, go to the Herbert Smith Freehills Kramer blog "ADR Notes" at https://www.hsfkramer.com/notes/adr/