RESOLVING DISPUTES WITH HMRC

This is the eighth in our series of ADR practical guides, designed to provide clients with essential 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 regulator, HMRC.

USE OF ADR BY HMRC

Her 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 fettered that discretion in a published 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 November 2013. The LSS provides for HMRC to engage in ADR to support the resolution of disputes with taxpayers.

Further, the procedural rules of the First-tier Tribunal (Tax Chamber) 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).

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 tax disputes are:

- confidentiality – particularly given the reputational risks faced by businesses in the context of current public and political attitude 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 intend most mediations to be concluded within six months.

FORMS OF ADR WITH WHICH HMRC WILL ENGAGE

If your tax affairs are dealt with by HMRC’s large and complex or large business services, and a dispute arises between you and them (a Large and Complex Dispute), HMRC will in appropriate cases consider engaging in either:

- facilitated discussion (a non-independent and non-evaluative ADR process); or
- facilitative mediation (an independent, non-evaluative ADR process),

to resolve that dispute.

HMRC may also consider engaging in evaluative mediation or non-binding neutral evaluation, but only where the issue in dispute is not a tax issue (for example, the proper meaning of a contract or the valuation of an asset).

If your tax affairs are not dealt with by HMRC’s large and complex or large business services, HMRC will still consider engaging in ADR in appropriate cases. In order to start the process in such cases, there is an online form to be completed to provide HMRC with the information necessary for it to consider the suitability of ADR, and HMRC will let you known within 30 days of submission of that form whether it considers ADR to be appropriate in your case. The remainder of this guide is focussed on Large and Complex Disputes only.
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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 consider 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, it appears that a third party could assist the parties:
- to understand, clarify or focus the issues between them (for example, to narrow the scope of any dispute);
- to re-engage in circumstances where their relationship has broken down; or
- to identify alternative possible settlement outcomes (in circumstances where a dispute had previously appeared binary in nature).

HMRC considers ADR is unlikely to add value (and therefore be appropriate) in cases:
- that turn entirely on points of law;
- where there are important points of principle or policy implications, or where resolution would require departure from an established HMRC view; or
- where HMRC suspect lack of integrity or wish to test the veracity or strength of the taxpayer’s evidence.

WHEN AND HOW THE ADR PROCESS IS STARTED

You can seek to engage with HMRC in ADR at any stage of a dispute – whether during pre-return work, during an investigation/enquiry into a return, or after a closure notice has been issued. 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.

You should bear in mind that engaging in ADR does not automatically stay any statutory appeal or case management deadlines (e.g., where litigation is in contemplation or has been commenced). Accordingly, if you wish to engage in ADR, you (and HMRC) should consider whether to: (i) agree/apply for a stay of procedural steps/proceedings; or (ii) progress ADR in parallel with any litigation processes.

Where you wish to engage with HMRC in ADR, you should raise the issue: (i) with your customer relationship manager (CRM) or dedicated case worker; or (ii) directly with HMRC’s Dispute Resolution Unit (the DRU). If your CRM/case worker (together with any other HMRC stakeholders – such as technical specialists) and the DRU agree that ADR would be appropriate, the DRU will authorise, and assist with making, any ADR arrangements. Where the HMRC team or DRU do not agree that ADR would be appropriate, your request will be referred to HMRC’s ADR Panel for consideration – this panel comprises a number of senior individuals within HMRC, including HMRC’s General Counsel and Solicitor. (It is possible for HMRC to approach you with a proposal to engage in mediation: in such cases, an internal process similar to the one described above will have been completed by HMRC in advance of their approach.)

PROCESS: FACILITATED DISCUSSION

Where you and HMRC agree to engage in a facilitated discussion, HMRC will usually aim for the process to be concluded within three months. Indeed, HMRC’s ADR Panel may make agreement of such a timetable a condition of entering into a facilitated discussion.

In any facilitated discussion, the DRU will appoint an externally trained HMRC facilitator. By agreement, you can also appoint a similarly trained facilitator to work in conjunction with the HMRC facilitator.

It is not uncommon to enter into a facilitation agreement with HMRC, addressing the same type of issues commonly covered in a mediation agreement, such as: (i) who has authority to bind each party; (ii) the status of the discussions (i.e., confidential and without prejudice); and (iii) any settlement formalities that will need to be complied with. This ensures that the process for reaching and finalising any agreement is clear, as well as securing that neither party is prejudiced (in any subsequent litigation) by having engaged in the facilitation process.

The facilitated discussion will usually last for one day only. Accordingly, proper preparation is essential, and – so far as possible – you should seek to:
- agree with HMRC in advance and, where necessary, with the assistance of the facilitator: (i) what points of fact/law are in dispute, and (ii) all practical arrangements (such as date, venue, attendees – in particular, decision makers); and
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- exchange with HMRC succinct written summaries of your respective positions in relation to the points of dispute and any questions that are required to be answered.

PROCESS: MEDIATION

Where you and HMRC agree to engage in a mediation, HMRC will usually aim for the process to be concluded within six months.

You should seek to agree with HMRC the form of mediation (usually a facilitative rather than an evaluative mediation) and identity of the mediator. Any proposed mediator will have to be approved by HMRC’s DRU, and it may take HMRC up to two weeks to conclude that approval process. It may also be appropriate to enter into an ADR process agreement and mediation agreement with HMRC. In this regard, and for practical tips on preparing for the mediation, see our ADR Practical Guide No. 5 “Preparing for Mediation”.

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 (see box). 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).

At a high level, HMRC’s governance process provides as follows:

In all cases:

i) that are sensitive (ie, where HMRC consider that a decision to resolve the dispute might have a significant and far-reaching impact on HMRC policy, strategy or operations and which are likely, in consequence, to prompt significant national publicity);

ii) where the tax at stake exceeds £100 million; or

iii) where the maximum potential adjustment is at least £500 million,

and in certain other cases referred to it by the business area boards referred to below, a panel of three HMRC Commissioners (including HMRC’s Tax Assurance Commissioner) must approve any proposed settlement (having taken recommendations from HMRC’s Tax Disputes Resolution Board, the TDRB).

The same process will apply to a sample of cases each year in which the tax at stake is between £10 million and £100 million.

Within each business area (such as Enforcement and Compliance (E&C); Large Business Service (LBS); and Specialist Personal Tax (PT)), a senior decision-making board will consider proposals to resolve cases with significant amounts of tax under consideration, or which raise novel points. There is also a decision-making board which considers cases involving transfer pricing issues (the TPB). In E&C, the board will consider cases between £15 million and £100 million. In LBS, the board will consider cases between £25 million and £100 million. In PT, the board will consider all cases over £10 million. The TPB considers cases between £15 million and £100 million (transfer pricing disputes involving tax at stake of between £5 million and £25 million are considered by panels within HMRC’s transfer pricing governance structure).

Smaller disputes are resolved by individual case workers (and technical specialists in more complex cases), overseen by their line managers. Where internal consensus between case worker and line manager cannot be reached, any settlement proposal will be escalated to deputy director level and, if necessary, director level.
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 not a 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 dues; 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 they 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.

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