

Tax deadlock

What is mediation and when can it be helpful, ask **KEVIN ELLIOTT** and **SUZIE MOORE**.

Alternative dispute resolution (ADR) occurs when a third party is brought in with the agreement of both parties to a dispute either to determine the outcome as an arbitrator or to facilitate agreement as a mediator.

In principle, ADR can be used to resolve disputes relating to any taxes and for a range of taxpayers including small and medium-sized enterprises (SMEs), and large and complex cases. The form of ADR most commonly used for tax disputes is facilitated mediation.

Our experience is that mediation has proved fruitful as a way of resolving tax disputes in the small and medium-sized enterprise space in particular. HMRC's annual report published on 13 July (tinyurl.com/y8gvbktc) revealed that total applications for ADR had increased from 581 in 2015-16 to 1,265 in 2016-17. Despite this hike in the number of applications, the success rate for resolving cases through ADR was a highly respectable 79.39%.

There has been less use of mediation in large and complex disputes. We understand this is due to the customer relationship manager, involvement of HMRC's large business directorate with a focus on collaborative working, and the availability of alternative escalation routes when more difficult disputes arise. However, we believe there is plenty of scope for using mediation in large and complex disputes in tandem with HMRC's approach to managing the relationship with large taxpayers.

Increasing the scope

The scope for using ADR is increasing. This includes the forthcoming ability for HMRC to issue – or the taxpayer to apply for – partial closure notices for discrete aspects of a multi-issue enquiry. This may enable different aspects of those enquiries to be dealt with separately by mediation or litigation.

KEY POINTS

- Formal mediation has proved very successful for resolving disputes in the small and medium business space.
- Benefits of formal mediation even after litigation has started.
- All-or-nothing issues can be suitable for mediation.
- ADR may even be a requirement under the tribunal rules – by analogy with the Civil Procedure Rules.



In its commentary on its Litigation and Settlement Strategy published in November 2013, HMRC identified four main reasons why a tax dispute may become entrenched:

- the parties have not established or fully understood the relevant facts;
- one or both parties have made assumptions about particular facts;
- there are differences between the parties about how the law applies to the relevant facts; and
- the parties have not discussed or fully understood their respective positions.

The use of the word 'entrenched' to describe a tax dispute that has not been resolved through ordinary means is apposite. It denotes a position of stasis and inaction. The provenance of the word has a number of strands, according to the *Shorter Oxford English Dictionary*:

- military – such as in the building of military fortifications;
- legislative – when a clause or provision (usually constitutional) is unable to be repealed except under stringent provisions; and
- political – providing in some manner for the perpetuation of political position.

What these strands have in common is that a position becomes entrenched due to positive action by the parties.

By contrast, mediation represents the extension of collaborative working between HMRC and the taxpayer with one important caveat. It introduces a third-party mediator into the dynamic of that dispute.

Departmental commitment

In recent years the department has demonstrated a commitment to mediation by training facilitators to process an anticipated increase in ADR requests and meetings. It is understood that

COMPANY DIRECTOR

There was a dispute about the level of benefit in kind charged on a company director. The relationship between the taxpayer and the HMRC case team had broken down. However, the HMRC mediator encouraged the case team to attend a facilitated meeting. Here, an unexpected compromise was reached based on an amount that was within the range of values produced by applying the HMRC guidance to the technical issues underlying the dispute.

This type of collaborative face-to-face negotiation that brings protracted correspondence to an end is a positive feature of ADR.

HMRC has developed internal mediation training with the aim of having at least one facilitator in each of its regional centres who will be able to discuss with decision-makers the suitability of cases for mediation.

The training of HMRC mediators is to be applauded given that having a skilled mediator involved in a dispute is not just about including an additional HMRC team member separate from the case team, or changing advisers or the negotiating team on the taxpayer's side. The mediator needs to encourage and allow the parties to produce their own ideas and creative solutions to resolve the dispute. They need to win the trust of the parties and not join either in the trenches.

The importance of deploying a skilled mediator is shown in *Company Director*.

Preparing for mediation

Consider first whether HMRC would accept the dispute for ADR.

In its guidance on ADR (tinyurl.com/nnvqct9), HMRC says the process can be useful if:

- 'You and HMRC have different views on exactly what's happened – the facts;
- 'Communication between you and HMRC has broken down;
- 'You need to know why HMRC haven't agreed evidence that you've given them and why they want to use other evidence;
- 'HMRC need to explain why they need more information from you;
- 'You're not clear what information HMRC has used and think they have made wrong assumptions.'

Implicit in this guidance, for HMRC at least, is that mediation is focused on factual and evidential disputes in which there are several possible outcomes.

However, mediation is not suitable if there needs to be a detailed testing of evidence. This is in contrast to disputes that turn on HMRC's application of the law, where there are policy implications, or where it would be required to depart from its established view to reach settlement.

Paragraph 18 of HMRC's Litigation and Settlement Strategy (tinyurl.com/y8g5wo82) reinforces this notion:

'Where HMRC believes that it is likely to succeed in litigation and that litigation would be effective and efficient, it will not reach an out-of-court settlement for less than 100% of the tax, interest and penalties (where appropriate) at stake. It therefore follows that, if the customer is unwilling to concede in such cases, HMRC will seek to resolve that dispute by litigation as quickly and efficiently as possible.'

Despite this, it is necessary to test whether what looks on the surface to be an 'all or nothing' dispute is so. The re-examination of legal and factual assumptions is, after all, at the core of a successful mediation, and the mediator will want to encourage the parties to come to the table with an open mind.

The resolution of a supposed all-of-nothing issue through mediation is illustrated in *Company*.

“It is necessary to test whether what looks on the surface to be an 'all or nothing' dispute is so.”

Practicalities

After the parties have agreed that the dispute would be amenable to settlement through mediation, preparations for the mediation hearing should be put in place. The taxpayer should also consider whether there should be a taxpayer co-mediator appointed along with the HMRC mediator.

A co-mediator is usually a legal or accounting professional, so the cost can increase. However, feedback from taxpayers suggests that they have found the joint mediation model gives them further assurance about the overall neutrality of the mediation team, and the co-mediators can provide each other with a sounding board. HMRC is usually content to agree to the appointment of a co-mediator.

COMPANY

A company sold a subsidiary and filed its tax return treating all elements as a capital receipt to be covered by the substantial shareholding exemption. The enquiries were more than four years old and there had been extensive correspondence and meetings between the parties. The technical analysis met with an impasse. Throughout the correspondence, the parties had assumed consideration of the matter between capital and revenue made it an all-or-nothing issue. However, during facilitated discussions, an alternative technical analysis of the facts was identified by the HMRC team and this resulted in a negotiated settlement agreed later that day. Testing whether a dispute really is all or nothing and identifying alternative valid technical analyses is another positive feature of ADR.

OPTIONS

Issue	Mediation	Litigation
The decision-maker	The parties themselves agree a mutually acceptable settlement position and retain control of the outcome.	An independent party, namely the judge, makes the decision for the parties.
Will the dispute be resolved?	Mediation may be unsuccessful in resolving the dispute though it should assist to narrow the issues.	The judge will resolve the dispute, though the initial decision will be subject to appeal.
HMRC policy issue	Unlikely to reach resolution through mediation.	The judge will apply the law rather than HMRC's policy view.
Confidentiality	Settlement through mediation will remain confidential.	The hearing is open to the public and the taxpayer's name will appear on the tribunal's website the day before the hearing.
Without prejudice privilege	Mediation can be conducted without prejudice to the arguments put forward at a tribunal.	The legal arguments and facts found in the hearing will be contained within the judgment.
Flexibility	Mediation is a more flexible process in terms of reaching settlement – for example, settlement over linked issues and tax years all rolled into one, with perhaps some assurance over future treatment based on assumptions.	In general, litigation will determine only the issues that have expressly been put in front a tribunal.
Cost-effectiveness	Mediation is usually more cost-effective than litigation and is also swifter when successful.	Litigation tends to be more expensive than mediation, and there is the possibility of an appeal or appeals. It tends to take longer than mediation end to end.
Group litigation	No group action available.	The costs of litigation can be reduced by entering into a group funding arrangement with taxpayers with similar issues where applicable, if one taxpayer agrees to be the test case.
Recoverability of costs	Usually each party will bear its own costs of the mediation.	In the First-tier Tribunal, costs are recoverable by the winning party unless the case is standard track or the taxpayer has opted out of the costs regime. Beyond that, the winner recovers their costs.

The next critical matter is to agree the exchange of position papers before the mediation. Sequential or mutual exchange can be agreed depending on the circumstances. The taxpayer's position paper should be an outline summary of the facts, legal issues and the taxpayer's initial negotiating position. Brevity is best. The position paper is likely to be the first time the HMRC mediator will have seen a summary of the dispute from the taxpayer's perspective – so the document needs to be accessible.

“ Before mediation day, advisers should discuss with the client a range of fallback positions. ”

Before the mediation day, the adviser should discuss with the client a range of fallback positions and encourage them to prepare an opening statement if this is possible. Ensure so far as possible that the decision-maker(s) from the client side attend the meeting. Press for the HMRC decision-maker(s) to be there as well. It should be possible for the HMRC mediator to identify the appropriate decision-maker(s) on its side.

Equally, the adviser should work with the HMRC mediator to ensure they and the client understand what the process would

be to conclude the settlement if an in-principle agreement can be reached on the day. Clarify where the dispute sits in HMRC's governance procedure: what approvals need to be sought by the HMRC case team higher up the food chain at HMRC, and whether final sign off is required from a governance board within HMRC such as the tax dispute resolution board.

Decision time

Mediation is often described as an alternative to litigation, and when disputes have seemingly reached an impasse both sides will need to consider whether there is the possibility of settlement by agreement or whether litigation is the remaining option. *Options* compares the relative advantages and disadvantages of each.

However, the start of litigation is no bar to requesting mediation. Indeed, the tax tribunal procedure rules for the First-tier Tribunal (tinyurl.com/y89dk4nz) (rule 3(1)) and the Upper Tribunal (tinyurl.com/y9whwdny) (rule 3(1)) require the tribunal where appropriate:

- ‘to bring to the attention of the parties the availability of any appropriate procedure for the resolution of the dispute; and
- ‘if the parties wish, and provided it is compatible with the overriding objective, to facilitate the use of the procedure.’

Although the rules stop short of mandating the use of ADR, they are clear statutory endorsement that ADR is a solution for resolving tax disputes that has the support of the tribunal. In addition, the use of ADR should be compatible with the overriding objective, in particular the need to deal with cases in ways that are 'proportionate to the importance of the case, the complexity of the issues, the anticipated costs and the resources of the parties' (rule 2(2)(a)).

Rule 44.2(4)(a) of the civil procedure rules (tinyurl.com/ycb7tr45) provides that one factor to be considered when deciding the issue of costs is the conduct of the parties. Increasingly, the courts are taking into account whether the parties try to resolve their dispute through ADR. The Court of Appeal set out guidance for this in *Halsey v The Milton Keynes General NHS Trust* [2004] EWCA Civ 576. The judge said the following should be taken into account in determining whether to apply a costs consequence:

- the nature of the dispute;
- the merits of the case;
- whether the costs of the ADR would be disproportionately high, and
- whether the ADR had a reasonable prospect of success.

There are no express cost consequences for a refusal to mediate in the tribunal rules. But it is likely that the overlay and practice of the civil courts would be borne in mind by the tribunal if such a refusal was unreasonable, either in terms of the tribunal imposing costs consequences for unreasonable

conduct or in assessing the level of costs to be paid by a losing party.

Mediation should therefore be considered both before and after commencement of litigation and HMRC should be prepared to give reasons for any refusal. The completion of the evidence-gathering stage of litigation is a perfect time to consider mediation: clarity brought to the facts by the finalisation of witness statements and formalising of documentary evidence relied on by the taxpayer will be an excellent starting point.

Conclusion

Tax enquiries are becoming more protracted and complex. One area where mediation may prove useful is when HMRC raises multiple issues across all the taxes with mid-sized businesses as part of the enquiry co-ordinator programme, sometimes referred to as 'cross-tax enquiries'.

Taxpayers need to consider their options carefully as mediation is not an easy option. Indeed, it has the potential to speed up the tax dispute process, ensure confidentiality for the taxpayer and enable the parties to retain control of the outcome. ■

Kevin Elliott is a director and qualified CEDR-accredited mediator and **Suzie Moore** is a solicitor in KPMG's tax dispute resolution and litigation team. Email kevin.elliott@kpmg.co.uk or suzie.moore@kpmg.co.uk; telephone 020 7311 2487 or 020 7311 4549. Thanks are extended to Claire Block for her contribution to this article.

TAX INTELLIGENCE DELIVERED TO YOU



Tolley® tax webinars provide a convenient and cost-effective means of meeting your CPD requirements without compromising the quality of your training.

Our webinars can be viewed on-demand for 12 months after the broadcast date and can be accessed from your desktop, laptop, tablet or mobile.

We offer a comprehensive range of webinars across the following topics:

- > Corporate and business tax
- > Private client tax
- > Tax for general practice
- > VAT and indirect tax

For further details:

- > visit www.lexiswebinars.co.uk/tax
- > email webinars@lexisnexis.co.uk
- > call 0845 520 5500

www.lexiswebinars.co.uk

Tolley®

Tax intelligence
from LexisNexis®