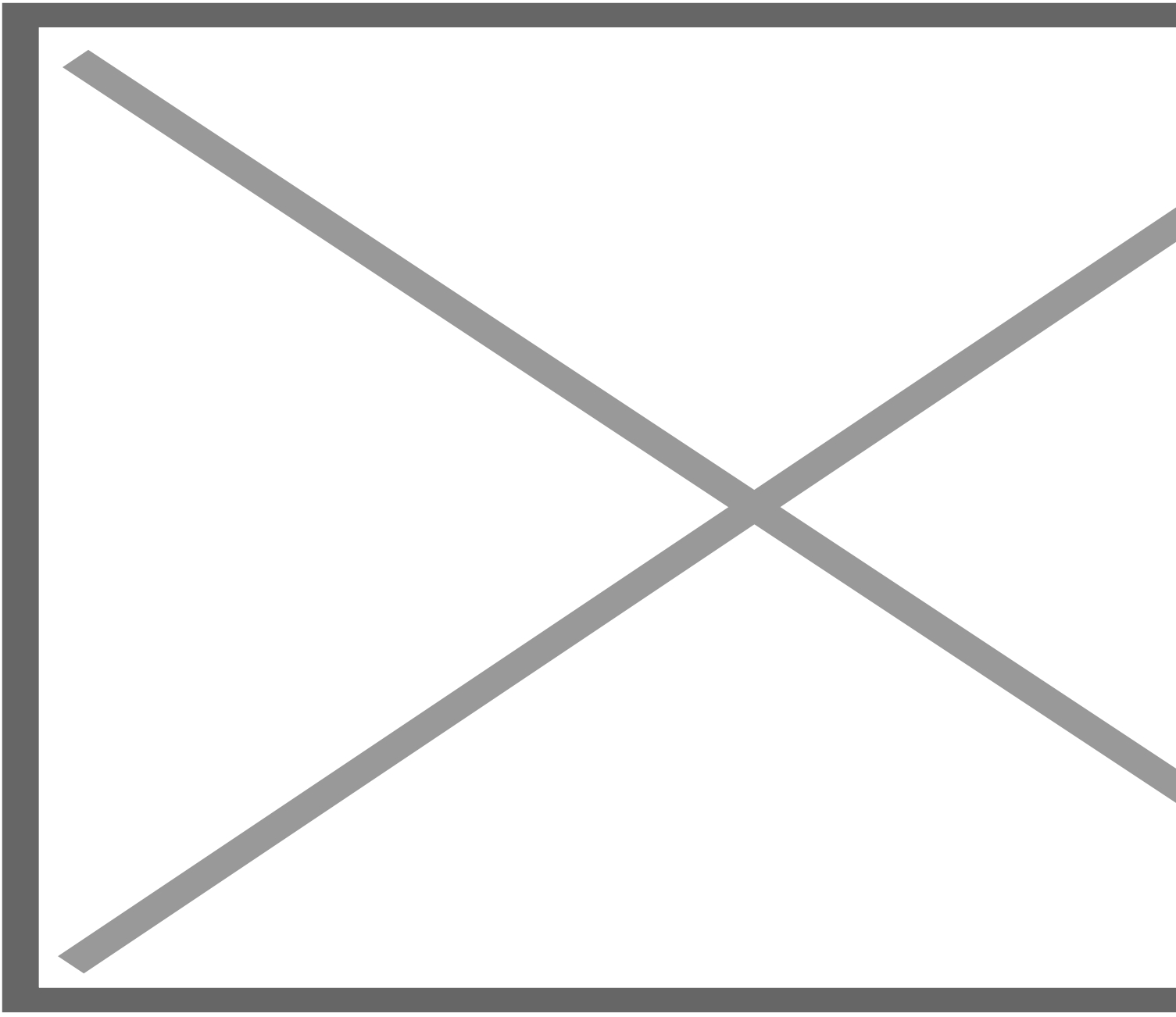
Lessons from Serpentine

Management of taxes



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Helen Adams and *Talia Greenbaum* consider the lessons for tax mediations that may be drawn from the *Serpentine Trust Limited* case

Key Points

What is the issue?

Two years after an ADR, HMRC sought to depart from an agreement reached between it and the taxpayer. It is essential that the parties can rely upon agreements reached during an ADR.

What does it mean to me?

The FTT confirmed that agreements between parties at the end of ADR can be binding. HMRC can make forward agreements in limited circumstances. Agreements that are wrong in law are beyond HMRC's powers.

What can I take away?

Advisers using ADR should ensure they appreciate the limits on HMRC's powers and what makes a valid contract so that any agreements reached at the end of an ADR do survive any subsequent challenges.

Since its formal inception in 2013 (following a successful two-year pilot) Alternative Dispute Resolution (ADR) has played an increasingly important part in tax dispute resolution. ADR was instrumental in resolving hundreds of cases in the past seven years. In recent years, awareness of this mechanism to resolve disputes moved from the fringes of the industry into the mainstream. This is primarily a result of investment by HMRC leading to intensive education and specialised training within HMRC and a move to recommend ADR as a means to accelerate resolution at various key points in disputes in accordance with its Litigation & Settlement Strategy (LSS).

ADR is essentially a facilitated process for mediating a negotiated conclusion to a dispute. The taxpayer and HMRC remain decision-makers throughout. The mediator(s) facilitates the process usually over one day. The aim is to reach an agreement in principle on the day, although details such as finalising calculations of tax, interest and penalties as well as HMRC governance approval follow subsequently before a formal agreement is reached, often under TMA 1970, s54. Recent ADR statistics show a significant year on year increase in the number of applications. The feedback from participants is overwhelmingly positive with 82% saying their case would not have settled without ADR and nearly 100% would recommend ADR in the future.

With success, however, comes dangers. ADR is a deceptively simple concept and the risks of underestimating its potential power and misunderstanding the framework within which it operates can lead to the sort of issue that requires the FTT's intervention such as in *The Serpentine Trust Limited v HMRC* [2018] UKFTT 535 (TC).

The Serpentine case

Serpentine Trust is a company limited by guarantee and a registered charity. The company operated a number of supporter schemes that offered subscribers a sliding scale of benefits in return for payments. The VAT consequences of these schemes was considered at an ADR that concluded on 31 July 2013, agreeing the future VAT treatment. HMRC issued assessments in 2015 covering the period from 2013, on a different basis to that agreed during the ADR. The company appealed.

The substantive issue before the FTT was the status of the document exchanged between the parties at the end of the ADR. It was headed 'This document records the agreement reached by close of discussions on 31 July 2013'. In particular the FTT considered whether the document formed a contract and, if so, whether the contract was void either because HMRC made a unilateral mistake or because the agreement was wrong in law and therefore

was ultra vires HMRC's powers.

The judge concluded that the ADR document was a contract as there was an 'intention to create legal relations'. Whilst there was a dispute over what the document meant, the contract was not void because of a unilateral mistake by HMRC. After considering CRCA 2005 and case law in this area, the FTT decided that what was agreed during the ADR 'was wrong as a matter of law' so 'the contract was ultra vires HMRC's powers and so void'.

A binding contract

Some reaction to the findings in the *Serpentine* case are alarming as some commentators concluded that 'this decision could be concerning for the future of ADR'!

The judgement should come as no surprise to those tax practitioners who regularly deal with ADR. ADR can be an effective mechanism for accelerating resolution in certain cases but both the taxpayer and HMRC expend time and resources preparing and attending the ADR day. In return, a key aspect of ADR is that any agreement between the two parties should be documented at the end of the day and that this document forms a binding contract (subject, where relevant, to HMRC Governance and in accordance with contract law). By deciding that the agreement in Serpentine was capable of constituting a binding contract the judge merely confirmed this.

It, together with other cases such as those referred to in this FTT decision, *Kyte v HMRC* [2018] EWHC 1146 (Ch) and *Rupesinghe v HMRC* [2017] UKFTT 834 (TC) are useful background reading for all practitioners assisting their clients with ADR. An appreciation of what constitutes a binding contract is important to ensure that what is drafted and agreed by both parties is sufficient.

Limitations on HMRC's powers

The second key lesson from the case is how central an understanding of the LSS and the limitations of HMRC's discretion in 'negotiating' a settlement is to the parameters of any agreement between the parties. Whilst ADR in the context of tax dispute resolution appears on the surface to be very similar in nature to commercial mediation, it is in fact a very different beast.

In particular, as clarified by the judge in the *Serpentine* case, HMRC has the power to agree a settlement provision for the future in very limited circumstances. In all cases HMRC has a statutory duty to secure the best practicable return for the Exchequer. In practice this means that HMRC cannot bind itself to a contract that prevents it from taking into account future changes to law or to taxpayer circumstances so agreements cannot be binding for a specific future period or be irrevocable. Additionally, HMRC cannot bind itself to a position that prevents it from applying a taxing provision ('other than in circumstances where the reason for that concession is for the purpose of HMRC's overall task of collecting taxes').

In the *Serpentine* case we see that something went very wrong in the ADR. In essence the ADR agreement purported to bind HMRC into accepting a position for the future which was contrary to their policy and which a 2014 FTT decision found to be wrong in law. This should not have happened.

Those attending the ADR day, including the mediator, the relevant tax professionals and the HMRC decision makers should be very clear as to the 'red lines' which mark the limits of any negotiated settlement.

The mediator in *Serpentine* was criticised by the judge for being an unreliable witness. We may have some sympathy for his unreliable memory given the passage of five years since the ADR day and the likelihood that

he kept no notes following the day, as is usual practice. This technical area was not one in which he was experienced and his role was not to give technical input; it was to use specialist mediation techniques to facilitate the parties' discussions as a neutral third party. Ensuring that the ADR agreement correctly and fully captures what was agreed on the day and ensuring that the ADR agreement does not bind either party to something which they cannot agree is the responsibility of each party present, not that of the mediator.

It is essential that taxpayers attending ADR are represented by an advisor who is well versed in the LSS and the scope and limitations of HMRC's discretion. Failure to have the appropriate expert in attendance can leave the parties exposed. Advisers should ensure that any 'red lines' on HMRC's side are flushed out before the mediation day if at all possible so that time is not wasted discussing ways forward which are simply impossible to achieve.

HMRC's Code of Governance

One final important point to note is the influence of HMRC's Code of Governance for Resolving Tax Disputes on any ultimate agreement between HMRC and the taxpayer. Taxpayers with a large or complex dispute (which may cover a number of risk areas) must be aware that the agreement reached in principle at ADR could require review and approval by the Tax Dispute Resolution Board (TDRB) or another HMRC governance board before becoming binding. The conditions for upward referral to a dispute resolution board (DRB) depends on the size of the particular tax risk as well as the overall tax at stake. In addition, if the matter has far-reaching implications or includes unusual or novel features then a ruling from a DRB is necessary before any agreement is formally accepted by HMRC.

It is worth remembering that the ADR in the Serpentine case took place in the pilot stage of ADR before HMRC decided to make ADR 'business as usual' in September 2013. Since then ADR has evolved. Ongoing collaboration between HMRC and the industry in order to identify and learn from mistakes, coupled with increased awareness and education, continuously develops and refines the model. It is particularly useful to have cases like Serpentine to serve as a timely reminder of the fundamental principles underpinning ADR of what can go wrong if these lessons identified are not learnt.