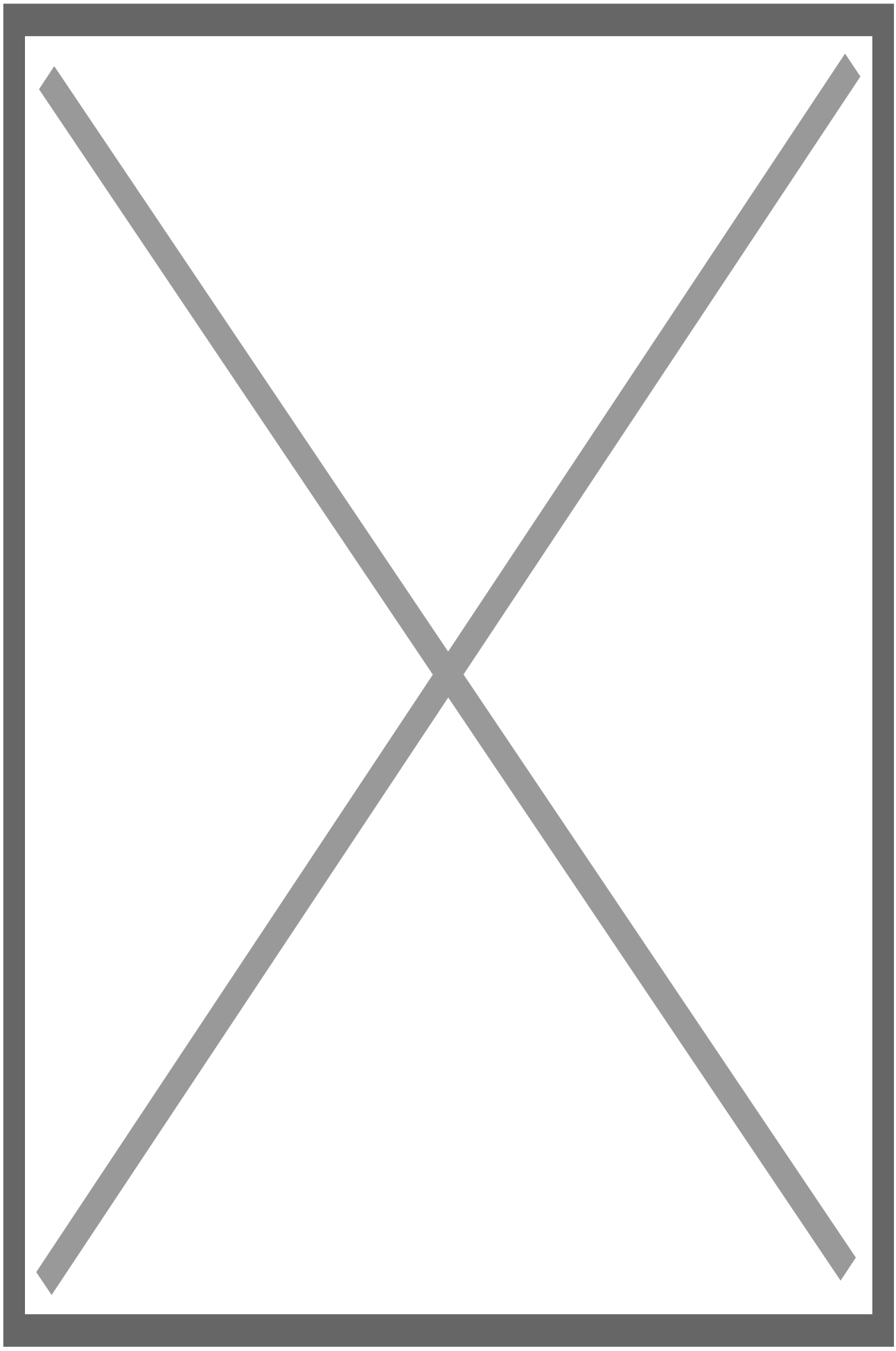
New routes

Management of taxes



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Dawn Register and *Talia Greenbaum* look at the options for resolving disputes with HMRC and recent results

Key Points

What is the issue?

Taxpayers who are in dispute with HMRC have got two distinct avenues to explore before committing themselves down the Tribunal route to arrive at a resolution.

What does it mean to me?

Alternative Dispute Resolution can be requested for any dispute that is sufficiently mature and the latest 2016 ADR results are encouraging, particularly for SME and individual cases.

Internal Review can also be requested but only once an appeal against a decision is made by the taxpayer. Whilst this is a simple option that can suit some disputes, there are many others where Internal Review is seen merely as a 'rubber stamping' exercise for the original decision.

What can I take away?

How to use these options and evaluate the recent results published by HMRC.

Very few people actually want to have their 'day in court'. For most taxpayers, taking a case to the Tax Tribunal to obtain a judicial ruling is expensive, time consuming and often rather daunting, to say the least.

The Tribunal is also a measure of last resort for HMRC. For the tax authority too it is expensive, a drain on limited resources and can lead to long delays in collecting tax revenue. Even following the introduction of Accelerated Payment Notices (APNs) and Follower Notices (FN) in tax avoidance cases there are still thousands of disputes where tax remains uncollected whilst the tax position is unresolved.
It is therefore in everyone's interest if disputes can be resolved satisfactorily without the need to resort to the Ministry of Justice.

In recent years taxpayers have two main avenues to pursue if they disagree with HMRCs position and are reluctant either to accept defeat or to leap directly into the Tribunal route.

One avenue is asking for or accepting a Statutory Review (also known as 'Internal Review') of HMRC's decision. The other avenue is asking for or accepting Alternative Dispute Resolution (ADR). It is important to note that these two avenues are not mutually exclusive and either or both can be appropriate depending on the circumstances.

ADR in practice

ADR is a mediation process that can facilitate the settlement of tax disputes where progress has hitherto stalled. It applies to all taxes and is therefore available for all taxpayers.

Unlike Internal Review (see more below), a taxpayer can request ADR at any point during the enquiry process provided that the dispute is sufficiently mature i.e., the taxpayer has provided the relevant facts and the areas of dispute are identified. ADR can therefore take place before a formal assessment is issued and a decision is made by HMRC.

It is important for a taxpayer to understand that if a formal assessment is issued and a final decision made by HMRC, they must continue with an appeal or ask for an Internal Review as well as asking for ADR, because the ADR process is outside the statutory appeal process and a taxpayer should preserve their legal right to appeal in parallel.

As mentioned above, ADR provides an alternative to the Tribunal as a way to resolve disputes. The objective of mediation is to reach a settlement which is owned by the parties rather than imposed by a judge or adjudicator, and which is practical and sustainable. Any agreement which is reached in principle on the day is then recorded in a settlement agreement. In certain cases, a settlement proposal may be required to go through a Governance panel before it can be formally accepted by HMRC.

HMRC will offer to provide an independent HMRC mediator for the ADR process without charge. This allows someone who has not been involved in the dispute to work with the two parties. The independence of the mediator is a point that HMRC is keen to stress. Although many taxpayers and agents are naturally skeptical of the independence of the HMRC mediator, feedback from taxpayers taking part in ADR showed that doubts expressed about the neutrality of HMRC mediators proved unfounded. The general experience was that mediators are experienced and senior HMRC personnel who tend to have a refreshingly pragmatic approach.

The person leading the mediation acts as a neutral third party mediator. They do not take responsibility for the outcome of the dispute: the decision making itself remains with the two parties. However, the mediator will work with both sides to explore ways of resolving the dispute through a series of both separate and joint meetings. They will help the parties to focus on the areas that need to be resolved and, if required, will help re-establish dialogue. In some cases HMRC and the taxpayer may both agree to jointly pay for a professional independent mediator, for example, from CEDR or another professional firm.

Even if a case is not closed via mediation, most parties will find the work and time involved is beneficial as preparation for a Tribunal hearing. ADR can narrow the issues in dispute and clarify the technical arguments of both sides allowing the case preparation to be more streamlined and the hearing to be shorter.

The latest results on resolving disputes

Recent feedback from HMRC indicates that ADR applications for the first half of 2016 nearly equal the number of applications for the whole of 2015, showing a continued pattern of acceleration in the use of ADR over recent years.

The Tax Assurance Commissioner's Annual Report for 2015/16 provides the most recent published figures for ADR. It shows that for small and medium-sized enterprises and individuals (SMEi) applications, 75% were accepted by HMRC into the ADR process and 62% of these cases reached a successful conclusion in the year. Of those that did not reach a successful resolution in the year, less than 4% are proceeding to litigation whilst the balance continue to seek resolution via ADR.

What the statistics show is that the vast majority of applications are accepted into ADR. The cases rejected for ADR in 2015/16 broadly fell into three main camps. Either because there was no 'live' dispute (i.e. no appeal had been made), or the case was stayed behind a lead case or the dispute related to a policy 'red line' matter.

The latest statistics also indicate that ADR is used far less frequently in ‘Large Business’ disputes. The lessons learnt in respect of these type of cases is that they lend themselves more to facilitated discussions rather than one day mediations.

In recent years HMRC has undertaken a comprehensive education programme within its ranks to raise awareness of ADR at all levels. Another subtle but significant change since the early days of ADR is that the Tax Dispute Resolution Board doesn’t get involved in deciding which cases are accepted into ADR. Instead the default position is that all cases are appropriate unless there is a good reason why they should be rejected. The Tax Dispute Resolution Board then reviews whether cases are correctly rejected.

The broadening of the ADR remit alongside the commitment of additional resources and staff can all be interpreted as a strong statement by HMRC that in their view ADR is a success to date and worth the investment for the future.

Our experience to date also bears out this conclusion. We find ADR is an overwhelmingly positive step on the road to dispute resolution when the right cases are chosen for the process. More general feedback suggests that, in some tax disputes, simply requesting ADR appears to motivate the parties to resolve the dispute themselves, without intervention from a mediator.

A parallel appeal

As above, it is important to keep a parallel appeal ongoing where HMRC issue a formal decision in an enquiry or dispute case. The Internal Review system is designed to give taxpayers a relatively quick and easy way to ask HMRC to review their decisions. The process is open to all taxpayers once HMRC have issued a formal conclusion or decision to a dispute.

It is a review by an independent Inspector (‘Review Officer’) who is not involved in the case to date. Often the file is sent to a completely different team in a different HMRC office. Alternatively it may be sent to the technical specialist in the field.

HMRC has 45 days to consider the case and issue their decision. If they cannot make a decision within that time then they must get agreement for an extension. In practice, extensions are often granted in complex and long running cases and to allow time for all papers to be reviewed in detail.

The case Inspector will not liaise with the Review Officer but the taxpayer and their agent can contact the Inspector conducting the review. If the outcome of the Internal Review is unsatisfactory, the taxpayer may make an appeal to the Tribunal within 30 days of the date that the Internal Review decision is made. It is important to carry on the appeal in practice in order to keep the case open and preserve the opportunity to go to Tribunal if all other options fail.

Does Internal Review work?

HMRC’s published statistics as per the 2016 Annual Report on Internal Review make for interesting reading. The first thing to note is that the vast majority of cases that are referred to Internal Review are penalty cases. Of these cases over half were cancelled completely or varied in some way.

Of the non-penalty cases, just over 30% of HMRC’s decisions were either cancelled or varied in the taxpayer’s favour.

Another distinctive point is that 87% of reviews were requested by unrepresented taxpayers. Looking at the statistics as a whole it is clear that Internal Review serves a specific, albeit limited purpose, allowing small high volume, low value cases to be dealt with efficiently and effectively.

A different story emerges where the cases concern a dispute on matters of policy or practice. In these instances HMRC's own internal guidance clearly states that the Review Officer does not have the discretion to go outside current policy and practice. This is all well and good unless the dispute is challenging the correctness of these policies and practices.

A further anomaly of the Internal Review process is that in cases where the matter in dispute is of a highly technical nature, the Review Officer will defer to the HMRC specialist on the matter. This specialist is often the same individual who determined the matter in the first place. In these instances it is hard to see how Internal Review can be any more than a 'rubber stamping' exercise.

Looking to the future...

So what can we learn from all of the above? Taxpayers and their agents would be wise to understand all the weapons in their dispute resolution armory. Both internal review and ADR have their benefits and their uses and should be considered as an alternative to the Tribunal.

Straightforward cases such as penalty appeals, technical cases where the technical specialists are not yet consulted or cases where the tax at stake does not justify the cost of going to Tribunal have all demonstrably benefited from following the Internal Review path.

In other instances, given the tendency for the Review Officer to rubber stamp the case Inspector's decision, Internal Review is unlikely to be recommended and in fact in some cases can actually be detrimental to the taxpayer's overall position.

In some instances there may be a number of issues, e.g. a corporation tax enquiry on ten aspects of a Return. The Review Officer will consider all ten issues even if agreement is already reached with the case Inspector. The result of the Internal Review could therefore be worse than the one already reached with the case Inspector.

ADR can step into the breach for the many cases that Internal Review fails. As stated above ADR has an impressive track record. But this too cannot be seen as a panacea for all disputes.

In complex technical disputes the policy 'red line' can often be a 'brick wall' during an ADR day to prevent the flow of meaningful discussions ultimately leading to settlement. It is certainly true that there will always be instances where an ADR mediation is not the appropriate forum to establish the correct policy position on matters that could have implications far beyond the case at hand. However, the fear is that HMRC will allow this legitimate concern to tar all complex technical disputes with the same brush. Indeed, who is to decide which complex technical matter concerns a 'red line' policy issue and which is something that HMRC can accept as an alternative valid interpretation?

We are living in interesting times with ADR still in its relative infancy and the practical experience is constantly evolving. Given the great potential for ADR recognised both by HMRC and tax agents alike, we are hopeful that it can live up to this potential rather than be strangled in its infancy by phantom policy 'red lines'.