

Agreeable disagreements

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Taxpayers large and small will not have failed to notice the increasing public and political pressure on tax authorities to ensure everyone pays their 'fair share' and the criticism of what might once have been seen as legitimate tax planning. Parliament's Treasury Sub-Committee inquiry, The Conduct of Tax Enquiries and the Resolution of Tax Disputes launched in March, is a timely prompt to reflect on whether it is possible to make the process of resolving disagreements with HMRC less disagreeable. Further, could this be more conducive to the correct amount of tax being paid with the least time and cost to HMRC and taxpayers?

The formal purpose of the inquiry is to examine whether HMRC's approach to conducting tax enquiries and resolving tax disputes meets the standards of fairness set out in its *Code of Governance for Resolving Tax Disputes* (the code of governance). This involves looking at six key questions.

- How do HMRC governance and settlement processes affect its ability to resolve tax disputes proportionately and fairly?
- Does HMRC's litigation and settlement strategy provide a rational and sound framework for resolving tax disputes?
- Do HMRC's collection and management powers set out in the Commissioners for Revenue and Customs Act 2005 provide the department with enough flexibility to achieve cost-effective and fair results?

- Does HMRC's approach to enforcing compliance with tax law, including its approach to penalties and other sanctions, result in disproportionate or unjust outcomes? If so, how can the situation be remedied?
- Is there sufficient governance over the whole of HMRC's enquiry process to ensure that HMRC's interventions are well-targeted and that taxpayers are treated fairly and professionally throughout?
- Do HMRC's governance processes provide enough scrutiny and assurance for clearances and approvals given to taxpayers outside the formal enquiry process?

Practical experience and a quick review of the responses submitted suggest that many feel that HMRC has responded to (undeniably significant) public pressure and perhaps limited resources by becoming more dogged and aggressive in its approach.

The result has been that enquiries demand increasingly greater and earlier commitment of taxpayers' resources and a concerted focus on efficient project management from both sides. However, and pending the Treasury Sub-Committee's report and HMRC's response to it, three key themes stand out in influencing how to secure the best outcomes for individuals and businesses in relation to disputes with HMRC:

- the rules of engagement;
- collecting evidence; and
- governance and settlement.

The rules of engagement

Although evidently not universally supported, HMRC's code of governance and its litigation and settlement strategy (the LSS) together comprise

the core framework for its conduct of tax enquiries and disputes. They underline the importance the Revenue places on taxpayers being open and collaborative and set out governance structures for the department to ensure taxpayers are dealt with fairly and even-handedly. Whilst arguably too rigid, the responses to the Treasury Sub-Committee are broadly supportive of having a framework, so this or an equivalent framework looks set to stay.

A key tenet of the LSS is that disputes must be resolved ‘in accordance with the law’. That principle may seem unobjectionable but it is, of course, more difficult if the taxpayer and HMRC disagree (often in good faith) about how the law is to be interpreted. The result is that they are then unable to engage in more constructive discussion about alternative - and possibly valid - analyses. This is compounded in disputes on issues when HMRC is fighting multiple taxpayers or believes there may be broader points of principle at stake - examples might be the meaning of a common phrase such as ‘tax advantage’ or ‘fairly represents’. In reality, except when the dispute is settled ultimately by litigation, resolving a disagreement ‘in accordance with the law’ can mean ‘in accordance with HMRC’s understanding of the law’ - and sometimes ‘in accordance with the most extreme version of the law taken so far, including on someone else’s facts’.

Discretion and litigation risk

A further important feature of this governance framework - and one that stands in marked contrast to normal commercial counterparties to a dispute - is HMRC’s approach to exercising discretion and assessing litigation risk. As a matter of law, HMRC has a wide managerial discretion as to the best means of obtaining for the exchequer the highest net return that is practicable having regard to the staff available and the cost of collection. So far, so sensible and proportionate. However, the LSS does not allow HMRC to ‘split the difference’ on issues characterised as ‘all or nothing’ - namely, those that the taxpayer is liable to pay either the full amount in dispute (if HMRC is

correct) or nothing at all (if the taxpayer is correct). In relation to such issues, the LSS states that, if HMRC believes that it is likely to succeed in litigation that would be both effective and efficient, it will not agree an out-of-court settlement for less than 100% of the tax, interest and penalties at stake. That unbending approach can prevent HMRC from acting as a rational party to a commercial dispute would - by taking into account factors such as the costs of pursuing the enquiry to its end and the risk of ultimately losing the case in court. (There are very infrequently any cost sanctions for HMRC.) There is, therefore, a significant benefit in engaging, if possible, with HMRC at the start of any process to keep a broader range of technical views on the table rather than the narrower ‘we’re right and they are wrong’ approach that can be tempting when defending a transaction or arrangement that taxpayers and their advisers have worked hard to implement.

The LSS, and many of the responses to the Treasury Sub-Committee, recognise that the lack of support or resources within HMRC can cause caseworkers to adopt a cautious and conservative approach. The LSS framework, particularly with recent changes, focuses more on ensuring that HMRC makes no unjustified concessions and less on managing disputes in an efficient, pragmatic and cost-effective manner. Consequently, taxpayers should think carefully - both at an early stage in an enquiry and throughout its course - about their appetite for litigation, the terms on which they would be prepared to reach a settlement and the technical basis on which that settlement could be presented to HMRC.

Collecting evidence

When dealing with an enquiry that covers multiple years or issues and complex fact patterns, one of the biggest challenges for the taxpayer can be simply how to manage the process of responding to HMRC’s extensive and wideranging information requests. In practice, key individuals on the taxpayer’s side may have moved on and systems may have changed, making it more difficult to find

documents. Enquiries that expand more rapidly than they progress can strain taxpayers' human and financial resources.

HMRC officials will need to show they have tested the facts to a litigation standard when going through internal governance, and this will be the benchmark in court if no agreement is reached. Consequently, there is real value in approaching the evidence gathering with a dispute resolution hat on from the outset, rather than a purely technical one. Critically, that is not about a 'drains up' review, but about focusing the work (and cost) on what will really matter. For instance, it helps if a realistic timetable for the enquiry is agreed with HMRC early on. Progress can then be monitored regularly by reference to this and the parties can discuss ways to ensure that the process stays on track.

Information requests

Likewise, working with HMRC to understand why information requested is needed - and whether the scope of the request could be narrowed, say by date range or using search terms - can save considerable time and cost. When progress seems to have stalled, 'without prejudice' technical discussions between HMRC and the taxpayer's advisers can be an effective way to move matters forward and maintain momentum. Responses to the Treasury Sub-Committee suggest this is not possible or not happening enough for many taxpayers.

In highly fact-sensitive cases, such as transfer pricing disputes or those involving 'motive' tests, HMRC may also wish to conduct interviews with key workers in the taxpayer's business. Interviewees can sometimes be nervous about inadvertently saying the 'wrong' thing or may not recall events that occurred many years earlier. As a result, they may come across as guarded or (naturally enough) be inclined to over-state the value of their job for the business. Identifying prospective interviewees early and helping them to feel relaxed about answering questions honestly and without

exaggeration is an important part of many tax disputes today.

Importantly, gripping the evidence process will put taxpayers in as good a position as possible to repackage documents or share interview transcripts with other teams at HMRC should there be any gaps in effective information management and internal co-ordination on the Revenue's part - for instance, when VAT specialists want to talk to the same people or read the same emails as their direct tax colleagues did previously.

Perhaps the silver lining to these evidential challenges is that the taxpayer can use the evidence-gathering process as an opportunity to test the strength of its case and evaluate the range of settlement options that it would be prepared to accept (or what litigation would really look like if the relevant documents or witnesses appeared in open court).

Governance and settlement

HMRC's caseworkers can deal independently with the resolution of some small and routine cases. However, settlement proposals concerning larger, more complex or sensitive cases must be referred by the case team to one or more specialist review panels, such as the customer compliance group dispute resolution board. Particularly high-value or sensitive cases may also need to be referred to the tax disputes resolution board.

In any dispute of significant size or complexity, therefore, the HMRC case team will be mindful from the outset that any settlement proposal will be subject to the scrutiny of the relevant review panel. A proposal may be rejected on the basis that the case team has not provided sufficient evidence and reasoning to show that the proposal accords with the LSS. Taxpayers must take this into account, therefore, when preparing evidence or technical arguments.

More difficult still, and an area both of challenge in the responses to the Treasury Sub-Committee

and of potential procedural vulnerability for HMRC, is that the taxpayer would not normally have an opportunity to put forward its own interpretation of the facts and law to the relevant review panel. Nor would it be able to review and comment on the papers that will be presented by the HMRC case team to that body.

Accordingly, the case team will want to make sure that it has covered (and is seen to have covered) all the bases and tested the facts before presenting a settlement proposal. Conversely - and as comes through in so many of the responses to the Treasury Sub-Committee - a major challenge for taxpayers is to ensure the case team (the members of which may often change or be relatively inexperienced) is given everything it needs to understand the relevant facts, the taxpayer's position (or potential position) on applying the law to those facts, and the political or public perception of the dispute or any high-profile settlement. This would place the team in a position to present a convincing argument when the settlement proposal goes up for review.

Looking ahead ...

We look forward to reading the Treasury Sub-Committee's report, and hope that it will include recommendations that help to empower HMRC to fulfil its statutory duties to manage and settle tax disputes in a more efficient, pragmatic and flexible manner, as well as supporting its staff to achieve these ends. Failing (and pending) which, taxpayers will need the full range of technical advice and dispute resolution support to navigate the current governance maze.

The months and years ahead will, no doubt, be a testing time for the UK's tax regime. With Brexit drawing closer, the government will be anxious to do all it can to ensure the UK remains competitive in the global market. Whilst tax rates may grab the headlines and the 'tax gap' may be used to pressure HMRC, when it comes to choosing whether to invest (or invest further) in the UK, the importance of fair, commercially minded and reliable tax administration is not to be underestimated.

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Richard Jeens
T +44 (0)20 7090 5281
E richard.jeens@slaughterandmay.com



Tom Gilliver
T +44 (0)20 7090 3462
E tom.gilliver@slaughterandmay.com

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