
Mediation in larger scale cases: taxpayers should beware of the emperor bearing gifts

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The period for tax practitioners to send comments to HMRC on its proposals for offering mediation as an alternative to litigation ended on 31 October 2011 and it will be interesting to see how HMRC decides to proceed. Although it is difficult to identify accurate statistics, the number of cases coming before the First-tier Tribunal (FTT) is increasing rapidly. According to the Tribunals Services Statistics for 2010/11, there were 17,600 cases outstanding in

the FTT on the 31 March 2011, as compared with 13,500 in 2010, notwithstanding there was more than twice the number of judicial sitting days in 2010/11 than 2009/10. With 42% of standard/complex track cases not being heard by the FTT within 70 weeks of receipt, there is a considerable incentive for taxpayers and HMRC alike to explore opportunities for dispute resolution in a swifter and cheaper manner.

HMRC's draft guidance

The trick is to identify the type of case likely to yield the greatest benefit from the mediation process. However, in making this assessment, HMRC's interests and taxpayers' interests may not always converge. In its draft guidance on mediation in large or complex cases, HMRC explains it has piloted two schemes, a small-scale pilot covering less than 20 cases involving large businesses or taxpayers with complex tax affairs, and a larger pilot involving around 150 small and medium sized cases. The draft guidance reflects the interim results of the small scale pilot and HMRC promises future guidance on using mediation in smaller and non-complex cases once the results of the larger pilot have been fully evaluated. It is a pity the draft guidance was not published in reverse, since taxpayers stand to gain more from the mediation process in a medium or small case than in a larger, more complex, one. Interim results from the larger scale pilot indicate that 97% of taxpayers accepted HMRC's offer of mediation, and of the 28 cases completed by May 2011, the dispute was resolved wholly or partly in 64% of cases.

Fact-heavy disputes

HMRC identifies a number of factors militating in favour of mediation as an alternative to litigation. Where it is difficult to pin down the essential points of disagreement or the parties appear to be at cross-purposes, mediation may restore a collaborative working relationship which sits more happily with the spirit of HMRC's Litigation and Settlement Strategy. HMRC also considers mediation may be particularly useful in fact-heavy disputes. But it is precisely in this sort of case that a taxpayer should be cautious about abandoning litigation. Where a case is fact-intensive, a taxpayer should not proceed on the basis that most probably the factual issues will be decided against his or her interests. On the contrary, where complex factual assertions underpin a taxpayer's case, intelligent adduction of relevant evidence may persuade the FTT to determine the key issues in the taxpayer's favour, producing a tax conclusion more favourable than that which could have been achieved through mediation. Similar considerations arise where a disputed point of law is involved. If credible arguments

can be advanced in support of a taxpayer's case and legal costs properly managed, the risks of litigation may outweigh the certainty of settlement through mediation. Indeed, the larger the amount of tax at stake, the less attractive the mediation process becomes.

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Other considerations

On occasions, there will be other considerations at play. While it is true that the disclosure process in litigation cuts both ways, since there is scope for HMRC to seek disclosure from a taxpayer of documents relating to tax advice and its implementation, those representing taxpayers in litigation may push at the boundaries of HMRC disclosure, where, for example, production of HMRC's working papers, correspondence and other notes is relevant to the determination of the point in issue. Experience in practice suggests that HMRC is a reluctant discloser, and coupled with concerns about delay, litigation costs, and the risk of an adverse determination which might set an unfavourable precedent or encourage other taxpayers to adopt a more belligerent line, negotiation of a settlement at the door of the FTT, or at some earlier stage in the litigation process, may deliver a more favourable outcome than the taxpayer would have achieved through mediation.

Where small sums of tax are involved

These considerations operate in reverse where a small sum of tax is involved. Neither HMRC nor the taxpayer will wish to incur legal costs obtaining witness evidence in addition to that of the principal protagonists, and pursuing applications for disclosure where smaller amounts of tax are at stake is unlikely to prove cost effective. Both HMRC and the taxpayer avoid litigation in a public forum, and the taxpayer retains an element of control which he would not enjoy if he proceeded immediately to litigation. In this sort of case, as well as achieving a much quicker result, the mediation process is likely to produce a better outcome for the taxpayer than litigation in the FTT.

In these circumstances, HMRC having led the presentation of its draft guidance on mediation in large or complex cases, final judgment on the likely efficacy of the proposal should be suspended until the results of the large-scale pilot involving medium and small cases have been analysed and HMRC has provided its guidance for the application of the mediation process in these cases. In the meantime, taxpayers engaged in dispute with HMRC would be well advised to beware of the Emperor bearing gifts by responding cautiously to any invitation to mediate in larger and more complex cases.

For an HMRC perspective, see 'Mediating tax disputes: HMRC's ADR pilots' (Sue Walton) Tax Journal, dated 15 July 2011.