Big business

Jonathan Fisher QC & Kate Balmer tackle mediation in larger scale tax cases

The use of mediation in civil litigation practice, as a form of alternative dispute resolution (ADR), has become increasingly commonplace in recent years. Most notably, interest has increased following the advent of the Civil Procedure Rules in 1998 and the government-wide ADR pledge in 2001 (renewed last year). Until now, however, the use of mediation within the tax field has been rare in the UK. This position may be contrasted with that in other countries, such as the US and Australia, in which mediation has long been used to resolve tax disputes. In Australia, a leading academic writer (Fayle, *Mediation in Tax Disputes* (1999)) has recently commented that "there are many instances where mediation may assist in resolving the dispute more equitably, more efficiently, more economically and more satisfactorily, leaving relatively untrammeled the relationship between disputants".

Notwithstanding, the introduction of express provisions relating to mediation in s 24 of the Tribunals Courts and Enforcement Act 2007 and ADR in reg 3 of the First-tier Tribunal (FTT) Rules 2009, HM Revenue and Customs (HMRC) have been reluctant to enter into mediation with taxpayers. This reluctance has undoubtedly been because of the special considerations which apply to HMRC as a public body exercising public law functions. The particular difficulty in mediating tax cases has been recognised at a European level in Art 1 of the EU Directive on Mediation, which notably excludes revenue and customs disputes from its ambit.

Last year, however, HMRC took some bold steps towards mediation. Between February and July 2011, HMRC conducted two pilot studies on the use of ADR in tax cases. Following the interim results of those pilots, HMRC published new draft guidance on ADR in large or complex cases in June. A formal consultation period, during which tax practitioners were invited to send their comments on the proposals, ended on 31 October 2011. It will be interesting to see how HMRC now decide to proceed.

HMRC's ability to mediate

It is important to note that, whether engaging in litigation or mediation, HMRC will still be required to operate within the confines of their litigation and settlement strategy (LSS). The LSS is the framework, introduced in 2007, within which HMRC seek to resolve all tax disputes. Under the terms of the LSS, HMRC will not compromise their view of the law in order to achieve a settlement or settle for less than they would reasonably expect to obtain through litigation. Notably, the LSS emphasises that HMRC will not enter into "package deals" or "split the difference" in all or nothing cases. The terms of the Taxpayers' Charter, such as the commitment to treat taxpayers "even-handedly", further constrain HMRC from entering into inconsistent settlements with different taxpayers. In those circumstances, the taxpayer appears unlikely to achieve a special "deal", in terms of the tax payable, through mediation. The benefit to the taxpayer may not, therefore, be immediately obvious.

Incentives to mediate

The "tax gap", which is the amount of tax lost in the UK through tax avoidance or evasion, is staggeringly high. In September 2010, HMRC released figures which estimated the tax gap in 2008–09 at around £42bn. Accordingly, HMRC are doing all they can to collect the right tax in the most efficient and cost effective manner. That, in turn, has resulted in a rapidly increasing level of litigation in the FTT, which hears appeals against decisions relating to tax made by HMRC. According to the tribunals services statistics for 2010–11, there were 17,600 cases outstanding in the FTT on 31 March 2011, as compared with 13,500 in 2010, notwithstanding there had been more than twice the number of judicial sitting days in 2010–11 than in 2009–10.

Litigation in the FTT is not, however, as swift as might be hoped, with 42% of standard/complex track cases not being heard by the FTT within 70 weeks of receipt. There is, furthermore, the obvious issue of costs which are, in the majority of cases, unrecoverable. In such circumstances, there is considerable incentive for taxpayers and HMRC alike to explore opportunities for dispute resolution in a swifter and cheaper manner.

Cases suitable for mediation

In determining whether or not it is beneficial to mediate in any particular case, it is important to consider the type of tax case and the issues involved. Certain cases are likely to yield the greatest benefit from the mediation process, others are not. However, in making this assessment, HMRC's interests and taxpayers' interests may not always converge.

> "HMRC identify a number of factors militating in favour of mediation"

In their draft guidance on mediation in large or complex cases, HMRC explain they have 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 promise future guidance on using mediation in smaller and non-complex cases once the results of the larger pilot have been fully evaluated. This guidance may take some time given that, earlier this month, HMRC announced an extension of the ADR trial in small and medium sized cases. 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.

HMRC identify 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 LSS. HMRC also consider 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.

Disadvantages in fact-heavy cases

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 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.

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 are relevant to the determination of the point in issue. Experience in practice suggests that HMRC are reluctant disclosers. When 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, this may mean that negotiation of a settlement at the door of the FTT, or at some earlier stage in the litigation process, could deliver a more favourable outcome than the taxpayer would have achieved through mediation.

Advantages in smaller cases

The above considerations operate in reverse where a small sum of tax is involved. In such cases, neither HMRC nor the taxpayer will wish to incur legal costs obtaining witness evidence in addition to that of the principal protagonists. Also, pursuing applications for disclosure where smaller amounts of tax are at stake is unlikely to prove cost effective. 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. 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.

Conclusion

In the present circumstances, judgment on the likely efficacy of the proposal should be suspended until the results of the extended large scale pilot involving medium and small cases have been analysed and HMRC have provided their guidance for the application of the mediation process in these cases. In the meantime, taxpayers engaged in dispute with HMRC would be wise to respond cautiously to any invitation to mediate in larger and more complex cases. NLJ

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