Analysis

Mediating tax disputes: all in a day's work?

SPEED READ **Alternative dispute resolution (ADR) processes to manage tax disputes have been used by HMRC as 'business as usual' for over a year. The traditional one day mediation is used for both SMEs and individuals; and in large and complex cases – an independent HMRC officer facilitates the first group, and a third party professional mediates the second. Increasingly, because of the nature of the issues involved, the use of facilitated structured discussions are used in large and complex cases using two mediation trained facilitators, one for each party, over a number of days. Mediation and facilitation techniques also have an application in managing international double tax treaty disputes between states, to improve the resolution of international tax disputes which are set to increase further as a result of the OECD/BEPS initiatives.**

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Four years ago, the prospect of resolving a tax dispute (where traditional negotiation was not working) by using some form of dispute resolution process, other than resorting to the courts, was a theoretical concept. It had only just been put forward as a proposal in an internal HMRC review (in 2009) of tax disputes, reporting on how to improve dispute resolution.

Four years later, following two successful pilot studies – one for small and medium-sized businesses and individuals; the other for large and complex cases – and successful outcomes in over 100 cases, the use of alternative dispute resolution (ADR) techniques (including formal mediation) for managing tax disputes is now applied by HMRC as 'business as usual', with the prospect in large and complex cases of customer relationship managers (CRMs) being given the mandate to discuss its use directly with their customers.

This article is based on the experiences of the author who, over the last 18 months, has facilitated two and mediated four tax dispute cases and describes the techniques and the experiences learnt in them.

ADR techniques in general

What are the ADR techniques now being used, which are succeeding in producing results not achieved by traditional negotiation?

The catalyst to all of the cases is the use of a third party trained in mediation skills (e.g. with the Centre for Effective Dispute Resolution (CEDR) or a similar organisation) who is appointed by both sides to facilitate the discussion between them; often restarting the process which might have broken down and become increasingly entrenched in position-taking.

In the case of a dispute involving an SME or an individual, HMRC's approach is to offer one of its own mediation-trained officers, independent of the dispute itself, to facilitate the matter without cost to the taxpayer. In the case of large and complex cases, a third party professional is usually appointed, with costs being shared equally by both sides.

In both cases, the facilitator/mediator's task is to engage with both parties, both individually and jointly, on a confidential basis. The process itself is to be conducted confidentially and on a 'without prejudice' basis. The facilitator or mediator is seeking to assess with each party:

- what the issues really are;
- where misunderstandings might have arisen; and
- what the potential outcomes might be once any such misunderstandings are resolved and the issues agreed.

It is a wholly voluntary engagement; both parties are in control of the outcome, but the mediator/facilitator controls the process.

A third party, engaging the trust and confidence of both parties at the same time, helps the parties to take a fresh look at their own case and at the arguments of the other side. Their positions are often tested, in confidence, by the mediator playing devil's advocate. The process should be approached with a positive mind set and a commitment to work together to try and achieve a settlement, or at least to narrow the 'gap', sometimes resolving only some of the issues and clarifying others, but in all cases making the prospect of any eventual litigation – if full settlement is not achieved on the day – more efficient, less time consuming and less costly.

In a typical mediation – certainly as far as commercial and other non-tax disputes are concerned – the process is conducted during the course of a single day with the mediator being appointed only a couple of weeks before the agreed date. The mediator will usually have spent some time talking to each party – often only on the telephone – about the process, and reading the papers selected by the parties and sent in confidence. A short summary of the case is drawn up, to be used by each party as the basis for a brief opening statement at the start of the process.

If matters are not resolved on the day, the mediator will remain in contact to assist the parties continue any productive dialogue. Many times, this results in a satisfactory settlement shortly afterwards.

How mediation differs in tax disputes

Is a tax dispute any different? In the author's view, there are differences and issues which are unique to tax disputes and which can result in the need for more active involvement by the mediator, both prior to the mediation day and after it.

In one case, it was clear at the outset of the process (at the time of appointment) that the taxpayer had concerns about the intentions of the HMRC team in agreeing to a mediation.

This was a fundamental issue of trust, and – with the mediator's involvement – it was sorted out, once it had been clarified that the mistrust had been based on a misunderstanding.

Once this had been resolved, both parties could move forward and, during the course of the few weeks before the mediation day, they made more progress in identifying issues and information relevant to the dispute than they had in the previous seven years since the dispute started.

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However, a more fundamental difference between tax and commercial disputes is the fact that a compromise agreement is not possible.

In a commercial dispute, both parties can come to the table with the authority to settle on any terms they like – often 'splitting the difference' between their respective best and worst case possible outcomes, and settling one element on more favourable terms in order to agree other elements.

Such an agreement, however, would be 'ultra vires' HMRC's 'collection and management' powers under The Commissioners for Revenue and Customs Act 2005 s 5. Any agreement reached in a tax dispute must meet the criteria set by HMRC's litigation and settlement strategy (LSS) (www.bit.ly/11qwKau). Often, in large and complex cases, the agreement must be referred to one of the appropriate governance bodies for final approval (see HMRC's *Code of governance for resolving tax disputes* at www.bit.ly/1nI39Bq).

In these circumstances, there can be a role for the mediator in the period between the mediation day and the day when the governance body meets. This is usually within one month, but may be later. The mediator can continue his confidential relationship with both parties to assess the progress of the submission being made by the HMRC team to the governance body, even to the extent of reviewing that submission and offering comments on it.

In tax cases, the mediator must take care to explore the levels of authority which each party has to reach a settlement on the day. The HMRC team should be tested to see whether they could obtain authority to settle within a range of possible outcomes, even if the settlement proposal still requires final approval. There have been cases where the HMRC negotiating team has agreed in good faith a proposal for settlement with the taxpayer on the mediation day, only to find on its subsequent submission to the governance body that it is rejected. This is not only frustrating for all concerned, but calls into question the credibility and benefits of the process in the first place.

What has been developing as a dispute resolution technique for large and complex cases – in preference to the single day mediation – is the use of facilitated structured discussions (see section 8 of *Resolving tax disputes: Practical guidance for HMRC staff on the use of ADR in large and complex cases*, www.bit.ly/1y57z8R). Here, two independent practitioners – an HMRC officer for the HMRC team, and another professional for the taxpayer – organise a series of structured discussions between the parties. They apply mediation techniques over a series of days and weeks, using 'decision tree' methodology to unwrap and examine the issues and applying a collaborative mind set in joint meetings, working together to identify solutions. In one case, the author acted as a facilitator, appointed by the taxpayer in a multifaceted dispute in which the HMRC team identified a technical solution to a particular issue that the taxpayer had not considered. The matter settled without litigation.

These are typically complex cases, where there would be little realistic prospect of resolving all issues in a single mediation day.

Which tax disputes are amenable to mediation?

The starting point is that any tax involving any taxpayer can benefit from the process, even cases involving anti-avoidance legislation. The types of cases which can benefit include those where: the parties are unclear or unable to articulate the points in dispute; there is a dispute over facts; there are entrenched views or strained relationships; and there is no dispute over technical analysis, but the parties need to agree a methodology to quantify liability.

However, HMRC will not mediate cases where an issue needs to be judicially clarified, so that the precedent gained can be applied to other cases. Nor will it mediate cases where a resolution could only be achieved by departing from an established 'HMRC view' on a technical issue (see HMRC's ADR guidance referred to above).

It is also not possible to mediate a dispute where there is only one answer. However, in the author's experience, what might at first sight appear to be genuinely 'all or nothing' in nature can – after further review, discussion and testing – turn out not to be an 'all or nothing' case at all, but rather a case where there is a range of possible outcomes. The LSS commentary encourages HMRC to test its initial conclusion (preferably with the taxpayer) and to explore whether there is a range of right answers for how the law should be applied to the facts; or whether the dispute can be broken down into two or more sub-disputes, each of which is could be separately resolved.

What does success look like?

The success of a mediation is not measured simply by whether a settlement of the dispute is reached on the day. It is not appropriate to talk in terms of

'winning' or 'losing'. A mediation can, and should, be regarded as a 'win win' situation for both sides. At best, the outcome is a settlement. At worst, the parties are better prepared for litigation, since they should both have reached a better, deeper and earlier understanding of the facts and legal issues that remain in dispute, and can jointly identify, articulate and agree the key questions that need to be resolved. In all cases, time and money is saved and working relationships can be restored.

As part of that process, a mediation can often uncover a wider range of possible resolutions to those generated by the traditional negotiating process. This is without detracting from the statutory correctness of the result, and by using a process which is not open to the courts. An example of this was the agreement, for an audit year, that the agreed transfer pricing methodology would apply to subsequent years up to the date of the mediation; and, for future years, an advance pricing agreement would be considered.

A wider role for ADR

The use of ADR – 'appropriate' (not just 'alternative') dispute resolution – techniques is now part of 'business as usual' in the more collaborative environment that HMRC is seeking to build with taxpayers in the management of domestic tax disputes.

The 2009 HMRC report also suggested that ADR techniques and mediation could play a significant part in resolving double tax treaty disputes between member states, where there exists in a double tax treaty between those two countries a mutual agreement procedure, including an arbitration mechanism. In these circumstances, both states know that ultimately the dispute will be referred to arbitration, if it cannot be resolved by settlement, and that the use of ADR processes could facilitate such a settlement, producing savings in time and cost and avoiding the need for arbitration.

In July 2013, the OECD published its action plan on base erosion and profit shifting (BEPS), endorsed by the G20 governments and recommending a series of actions.

Action 14 recommends that dispute resolution mechanisms should be made more effective. This has generated a fresh initiative to consider the use of ADR and mediation techniques in the resolution of international tax disputes between countries.

The author believes the use of arbitration in an international tax dispute can be made more effective and acceptable to the countries involved, if it were also to be enhanced with the introduction of ADR techniques and procedures, supporting the dispute resolution process where arbitration would be the final stage in that process. ■

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