

Analysis

ADR and its role in tax litigation

SPEED READ The updated *Litigation and Settlement Strategy*, published July 2011, sets out a roadmap to enhance both litigation and settlement as a means of resolving disputes, and the use of alternative dispute resolution (ADR) techniques will go a long way to improve the efficiency of both of those processes. There will always be litigation on points of principle, policy and technical uncertainty, and the Courts need to be freed up to pursue such issues without unnecessary delay. But ADR can help achieve this by testing whether an issue is in fact 'all or nothing', or whether closure notices can be framed in such a way as to narrow down the point to be litigated to its agreed essentials.



Peter Nias is a CEDR accredited mediator and former Partner and Head of Tax at McDermott Will & Emery in London. He specialises in tax dispute resolution work and is joining Pump Court Tax Chambers as a mediator to develop their tax mediation and dispute resolution practice. Email: peter@peternias.com; tel: 07889 657755.



Geoff Lloyd is an Executive Director in Ernst & Young's Tax Controversy & Risk Management practice with a special responsibility for collaborative dispute resolution work. Geoff is the former Head of HMRC's Dispute Resolution Unit and a CEDR and ADR group accredited mediator. Email: gilloyd@uk.ey.com; tel: 020 7951 8736.

Last year (in July) HMRC published its refreshed *Litigation and Settlement Strategy* (LSS), together with draft guidance to its staff on its application and draft guidance on the use of Alternative Dispute Resolution (ADR) procedures in large and complex cases.

Far from heralding a return to the days of 'doing deals' or going soft on taxpayer compliance, the updated LSS sets out a roadmap to enhance both litigation and settlement as a means of resolving disputes, and the use of ADR techniques will go a long way to improve the efficiency of both of those processes.

In summary, it is our conviction – already being borne out in practice – that litigation as well as settlement can benefit from the new approach and the techniques deployed in it.

The ADR pilots

In the run-up to the publication of this material and the launch of the LSS, HMRC explored whether ADR – specifically the involvement of a third party mediator – might be used in some tax disputes in order to facilitate agreement with the taxpayer. Two separate ADR pilots were undertaken. A small-scale one, covering less than 20 cases and involving larger businesses or taxpayers with complex tax affairs, and a larger pilot involving primarily small and medium-sized enterprises covering around 150 cases.

In the larger cases a third party accredited mediator was envisaged; in the smaller ones an

'in house' HMRC trained facilitator. The common feature of both was the use of a 'third party' mediator/facilitator to move forward long running disputes that were heading towards litigation.

The catalytic effect of a third party was usually sufficient to break an apparent impasse that had built up. It helped to identify mutually acceptable solutions; gain a better understanding of the facts and technical analysis; and identified the features in the dispute that were important to each party.

For the majority of the larger cases, rather than going straight to mediation, the ADR process involved the use of preliminary facilitated structured discussions where both parties sat round the table (not opposite each other) with meetings 'conducted expressly on equal terms recognising the dispute as a shared issue which the parties have a shared interest in resolving'.

Such a collaborative and consensual approach is essential. In cases where one or more of the 'stakeholders' do not initially adopt this approach, it is noticeable how much less progress is made.

HMRC's draft guidance

The ADR draft guidance *Resolving tax disputes: Practical guidance for HMRC staff on the use of alternative dispute resolution in large and complex cases* (27 June 2011, available via www.lexisurl.com/t4LDV) explains the process – with the emphasis on taking a collaborative approach throughout – and sets out in a series of annexes a number of useful practical papers.


Annex 1 is the template used by HMRC to notify the HMRC Dispute Resolution Unit of a potential ADR case. The template identifies reasons why the dispute is a potential ADR case, eg, dispute over facts, cost efficiencies, impasse in negotiation, preparation for litigation.

Annex 2 provides a template for an ADR process agreement and Annex 3 is a checklist for HMRC of items that the case team may wish to consider in preparation for mediation – most notably what parameters there are for negotiation on the issue in dispute. HMRC's 'red', 'amber' and 'green lines' range from where no movement is possible to where there is a range of acceptable answers.

There are two points to note with this.

First, HMRC has made significant progress in thinking through the processes of managing a dispute. In sharp contrast to the position in 2007, when the publication of the original LSS was followed with no HMRC-wide guidance or formal training for staff, an ambitious and extensive training programme is now under way.

Second, the ADR process is improving the process of litigation, as well as settlement. There is already evidence, going beyond the pilot studies, of ADR helping the parties reach a better, deeper and earlier understanding of the factual and legal issues which remain in dispute. This opens the way for the parties to agree, without prejudice, a common understanding on some or all of the facts, valuation methodologies (if any), accounting issues and

 For related reading, visit www.taxjournal.com:

Roundtable discussion: Using mediation to resolve tax disputes (Val Hennelly & others, 26.1.12)

News: Alternative Dispute Resolution trial extended (Andrew Goodall, 15.2.12)

HMRC's ADR pilots: lessons learned (Sue Walton, 14.7.11)

The refreshed Litigation and Settlements Strategy (Dave Hartnett, 14.7.11)

When might ADR be appropriate for tax disputes?

The experience gained with the ADR pilots has suggested that there is a wide range of features which can make a tax dispute particularly suitable for an ADR process. These include:

- uncertainty over the facts, or over which facts are relevant to the dispute;
- fact-specific cases where there is limited precedent value or where there is likely to be a range of possible outcomes which could be regarded as robust in law;
- a lack of clarity/understanding of the parties' respective technical analysis of the tax law in question;
- cases where positions have become entrenched based on early conclusions (or assumptions) about the facts, or on what appears to be an 'all or nothing' interpretation of tax law, where there may be scope to explore alternative realistic ways of looking at the facts, or alternative analyses of the law, either of which may unlock the impasse;
- cases where genuine attempts to work collaboratively to resolve the dispute have stalled; and
- two or more taxpayers involved or potentially affected by a specific dispute who might be prepared to take part in a confidential dispute resolution process.

Features which can make a tax dispute less suited for an ADR process include:

- where there has been little or no bilateral engagement between the parties to date, or where productive discussions between the parties are ongoing, or where alternative (accelerated) collaborative working processes are available which make ADR unnecessary or premature;
- where the taxpayer (or their agent) is unwilling or unable to commit to a co-operative and collaborative approach;
- a fundamental difference in legal interpretation between the parties where HMRC has a clear policy which it wishes to maintain and there is no obvious lack of clarity in relation to the facts or each other's interpretation of the law; and
- an issue which affects a large number of taxpayers with significant amounts of tax revenue at stake.

Extract from 'Using mediation to resolve tax disputes' (report of a roundtable discussion involving Val Hennelly, Jonathan Levy, Geoff Lloyd and Graham Massie, previously published in Tax Journal dated 27 January 2012).

The use of ADR techniques will go a long way to improve the efficiency of both litigation and settlement

technical points of law, leaving only the balance to be litigated.

For example, instead of an agreed statement of facts, which simply references transactions that have occurred in the terms that are described in the relevant legal documents, ADR techniques can be used to develop an agreed, realistic, view of what has happened. This in turn helps each party to stay in control of questions of fact, leaving only questions of law to the jurisdiction of the courts.

Indeed, the ADR process can be particularly useful in determining early on what facts are relevant, in order to reach agreement on a

statement of facts. HMRC's guidance on the LSS recognises that disagreement over the relevance of particular factual questions is a common challenge in tax disputes: a third party can be useful in breaking this logjam, even though it is only one staging post towards resolution of the dispute as a whole.

The ADR process will improve the efficiency of litigation in helping the parties prepare more effectively, achieving significant time and cost savings. In fact, there is little 'downside' to the process as all work and preparation involved is likely to be of direct relevance and use to litigation, in the event the ADR procedure is unsuccessful.

For example, in one tax dispute where agreement was reached during the formal mediation stage, the HMRC case owner estimated that resolving the dispute through the ADR process rather than taking the case to the First-tier Tribunal, may have saved around 45–60 days work for the HMRC team. This is likely to have been matched by similar savings for the taxpayer. The costs of the Large Business ADR pilot mediation itself (which have been split 50:50 for all tax disputes) have also resulted in a fraction of the legal costs likely to have been incurred in litigation. Similar costs savings have been achieved in the SME ADR pilot.

There will always be litigation...

There will always be litigation on points of principle, policy and technical uncertainty, and the Courts need to be freed up to pursue such issues without unnecessary delay. The ADR process can help achieve this by testing whether an issue is in fact 'all or nothing', or whether closure notices can be framed in such a way as to narrow down the point to be litigated to its agreed essentials. For example, in one dispute that was already many years old, the parties had lost sight of the critical issues and neither party was able to clearly articulate the key questions that needed to be answered in order to resolve the dispute. Going through a process of jointly identifying, articulating and agreeing what these key questions were, helped refocus the parties on the important issues and also provided a framework for further discussion.

In one of the pilot studies, facilitated discussions led to both parties concluding that the most efficient way of resolving the dispute would be through litigation. But having come to this decision, the parties continued to work together to make the litigation process as efficient as possible by narrowing down the scope of the dispute to be litigated and agreeing questions that needed to be answered by the court.

In the majority of cases, the opportunity for resolving disputes by settlement and dispensing with the need for litigation altogether must be the optimum result. However, there are also opportunities for using ADR techniques to enhance the litigation process, which should not be overlooked. ■