

HMRC, Taxpayers and Agents

Some topical issues (Spring 2011)

HMRC litigation and settlement strategy

HMRC are currently reviewing this. There has been much speculation in the press regarding whether it fetters HMRC's ability to negotiate if it thinks it has got better than 50% chance of success. Alternative dispute resolution (eg. mediation) is likely to be recommended, especially given the fact that the FTT rules push a Tribunal to discuss mediation as an alternative mechanism of resolution to taxpayers and their representatives.

Relevance

■ Taxpayers

Most taxpayers will be subject to an enquiry, which they will want to settle as quickly and cost effectively as possible. Often this is done by negotiation, but where there are points of principle on which HMRC think they have the upper hand, the taxpayer may well fight. Costs are an issue (see below) but knowing what HMRC's policy is towards settling, or resolving the dispute through facilitated negotiation/mediation is clearly important. There are policy issues here. To what extent can HMRC settle with one taxpayer if it isn't prepared to do so with another? What are the roles of in house/external tax advisers and lawyers in resolving any dispute?

■ Agents

In addition to the above, it is important for agents to understand what is involved in a dispute, the extent to which costs can rack up and how disputes can be resolved without damaging the client relationship.

DOTAS

Changes to the DOTAS regime came into effect on 1 January 2011. These accelerate the time when a promoter must disclose a scheme to HMRC. The promoter will also have to submit client lists including details of any intermediary or client if the promoter comes to hear that the scheme has been implemented.

Relevance

■ Taxpayers

Taxpayers may be identified on a client list before they would otherwise be obliged to disclose a scheme if a promoter hears that they have used a promoted scheme. They might also have, promoted to them,

fewer schemes, since the promoters will want to ensure there is no obligation to disclose until the last minute. So the sort of schemes that we have got up our sleeve regarding (for example) conversion of income to capital on share options, can't be discussed in detail with taxpayers unless they become clients. In these circumstances privilege may apply and disclosure can be deferred until implementation.

■ Agents

In addition to the above, agents must guard against the possibility of being scheme promoters thus accelerating the obligation to disclose details of the scheme to within five days of making a marketing approach of a substantially designed scheme. Penalties are now draconian. Schemes promoted pre 1 January can be "refreshed" post 1st January 2011 thus generating a disclosure obligation.

Penalties

Tax geared penalties are now firmly bedded in for all significant taxes. Up until September 2010 a total of £12m or so raised. Most resulting from VAT (60%) and ITSA (34%). Most of the penalties (£9m) arise from failure to take reasonable care. Where there is an international flavour, the penalties can be enhanced to 1.5 or 2 times the domestic level. HMRC currently publishing spotlights etc, and other informal (eg. on SDLT) papers on what it think works and doesn't. Proportionality of penalties is also a live issue.

Relevance

■ Taxpayers

The test for reasonable care is three-fold (what would the reasonable person do, what is market practice, there must be a balance between cost and benefit). Does reliance on an appropriate agent always work? What systems do we need to put in place to ensure that you behave reasonably? How do HMRC assess penalties? Important that taxpayers understand the review and appeal process.

■ Agents

In addition to the above, agents must guard against the possibility of being scheme promoters thus accelerating the obligation to disclose details of the scheme to within five days of making a marketing approach of a

substantially designed scheme. Penalties are now draconian. Schemes promoted pre 1 January can be "refreshed" post 1st January 2011 thus generating a disclosure obligation.

Tax avoidance

Graham Aaronson and his merry men are reviewing whether a general anti avoidance rule should be introduced. Currently there are a number of targeted anti avoidance rules. Most of these contain a motive test. There have been a number of abuse of rights cases recently which, although more relevant to VAT, have an impact on the direct tax position. Reputation risk, NAO review and Wikileaks are all affecting the appetite for products/schemes.

Relevance

- *Taxpayers*
What seems clear is that of the two alternative ways of concluding a transaction there is no obligation to take the route which pays most tax. However taxpayers will need to be able to show that there are commercial reasons for doing so, and (abuse of rights) these are part of the normal commercial operations. Documenting commercial reasons for decisions is crucial. What are others doing? Is a strategy against the "evident intention of Parliament"?
- *Agents*
In addition to the above, agents need to consider the appetite for banks etc to become involved in financing schemes; and whether credit will take longer to obtain for a deal if there is a tax kicker.

Legitimate expectation

HMRC have always been prevented from resiting from an opinion about a given transaction under the Sheldon Statement (a specific query raised with HMRC to which an unequivocal answer has been given) or a response to a statutory or non-statutory ruling. However, increasingly, taxpayers are raising the principle of legitimate expectation in tax appeals. There is some doubt at present as to whether the principle can be raised in the FTT, and the extent to which it will apply in the absence of any specific answer to a specific query. The *Hanover* case (under appeal) suggests that HMRC are not bound if an adviser uses HMRC guidance to advise a client.

Relevance

- *Taxpayers*
Taxpayers may be adopting a filing position based on "long usage" or a method which is broadly non-statutory but to which HMRC have turned a blind eye. What if HMRC turn around and want to change things and claim back tax? To what extent are you protected? To what extent should you go for specific rulings? What are the limits to the doctrine?
- *Agents*
In addition to the above, agents need to be alive to the doctrine and to plead it as part of any negotiations with

HMRC. In light of *Hanover*, it may also be better for agents to get their clients to rely on the guidance rather than passing it on second hand.

Working with tax agents

Negotiations on working with tax agents continues. At present a tax agent will only be impugned if he/she has behaved dishonestly. A finding of dishonesty will bring with it an obligation to pay penalties and a document/information disclosure regime similar to (but separate from) the schedule 36 provisions.

Relevance

- *Taxpayers*
HMRC will want to know the identity of taxpayers for whom a rogue agent has acted so that they can unpick his/her clients tax affairs to see if there is a loss of tax.
- *Agents*
In addition to the above, agents will need to check that they understand the common law of dishonesty especially where a tax strategy does not require the submission of a document to HMRC.

Costs

The FTT only have power to award costs if an appeal is complex tracked and only then if they are incidental to the proceedings. So this won't cover costs, for example, of seeking a review. Unless HMRC behave unreasonably, then costs are only available if the case allocated to a complex track. Recent cases clarify the application of the criteria for such allocation. Recent cases show that FTT cases are not contentious business so no need for formal CFA (although CFA and contingent fees in the melting pot given the Jackson review). Without prejudice save as to costs, and part 36 offers can be made but can they be relied on in the upper courts?; a recent case shows that if HMRC don't beat the offer, costs on an indemnity basis will be awarded from that date.

Relevance

- *Taxpayers*
Costs, as always, need to be thought about at the outset. Is litigation the best route or might mediation be more cost effective? If you go for a review which incurs cost and delay, will you ever get that back? To what extent can you enter into conditional or contingent fee arrangements with your advisers? What about HMRC costs if complex tracked and you lose? After the event insurance - is there a role for this? What about cases brought originally under the old regime but now in the new cost regime?
- *Agents*
In addition to the above, agents need to identify the best team to put together to safeguard clients' interests if the matter becomes contentious. There is room for both legal and accounting advice. The usual issue is to identify the appropriate project manager.

Data disclosure

Recent publication of *“Professional Conduct in relation to Taxation”* (4 January 2011) endorsed by (amongst others) ICEAW, CIOT, ATT suggests that members may find it *“helpful as a precautionary measure to have identified a lawyer or other practitioner with relevant specialist knowledge of both civil and criminal law from whom he can obtain advice in [relation to the access, inspection and removal of data].”*

Relevance

- *Taxpayers*
HMRC civil powers under Schedule 36 are extensive and no longer is a search warranty required to inspect premises and records on them. It is important to ensure that information that is sought of you is not handed over without some thought given as to whether you have to, and if not, whether it would be tactically propitious to do so. If HMRC do wish to inspect, or obtain information or documents by way of a notice, you need to be aware of your rights, the impact of privilege, and what sanctions HMRC can impose should you fail to deliver.
- *Agents*
In addition to the above, and the admonitions of the various supervisory bodies to get close to a decent lawyer, agents may be reluctant to advise on notices/warrants/searches. There may also be conflict issues.

Privilege and disclosure

The *Prudential* case shows the privilege firmly attaches to advice given by lawyers, but not advice given by accountants. Privilege also has an impact on DOTAS where the obligation to disclose is pushed on to the user, unless it is waived. Disclosure of documents is fundamental to the litigation process. How can privileged documents be, practically, protected from an inspection or raid.

Relevance

- *Taxpayers*
Privilege may be important; it may be irrelevant. Often information is published in non-privileged form. Where motive tests are involved, privileged information may need to be disclosed anyway to show purposes of deal, tax advice received etc. If a taxpayer has a legal opinion saying what the advisers think of the tax consequences of the deal, then if it is ever litigated, HMRC will have their own views, so unlikely you will be handing HMRC a crown jewel argument. But it is important to consider privilege; and if it is important/desirable, to ensure privilege attaches to the advice and that there is limited circulation of privileged documents.
- *Agents*
In addition to the above, privilege for lawyers isn't much of a marketing advantage. Information usually gets out in non-privileged form, early on in advice/transactions. How far does it extend in relation to DOTAS? This needs to be clarified since it may push disclosure back if advice regarding a scheme is privileged (compare with the position where a marketing contact is made by a lawyer).