

DISPUTES WITH HMRC: WHY THEY ARISE AND HOW TO RESOLVE THEM

By David Goldberg QC

A few weeks ago, a retired General of the British Army came to see me.

He had fought in the Bosnian War and in The Troubles; he had fought in Iraq and in Afghanistan; he had, as soldiers do, walked in the valley and stood on the mountain top; he had done a lot of soldiering and seen a lot of action; he knew how to defeat an enemy and, to him, Saddam Hussein, ISIS and the Taliban were as nothing.

But, when he came to see me, he was facing an enemy of an altogether different order, an enemy which was proving to be tougher by far than any he had come across before, an enemy he did not know how to defeat.

Who or what, I hear you ask, is this enemy, with the cunning and the strength to daunt an experienced and brave soldier?

The answer is officials of HMRC who had, as it were, trapped the General (or, more accurately, the business for which he worked) in the fiscal equivalent of the Normandy bocage and left him feeling that he was bogged down, that he was getting nowhere, that he did not have any plan to escape from this entanglement and no idea how to formulate a plan.

The experience is, nowadays, not at all uncommon when taxpayers have to deal with HMRC; and the true story of the General is apt partly because it links disputes about tax with the military and partly because any dispute with HMRC is, viewed realistically, a form of warfare.

Although any dispute with HMRC will, more or less inevitably, begin with negotiation, it can, nowadays, easily escalate into

litigation which, adapting what von Clausewitz said of diplomacy and war, is or should be seen as negotiation by other means.

But I have made an assumption, which I need to examine, that HMRC are an enemy and I have jumped straight to disputes without discussing either how or why they arise or their mechanics: I should say something about the how and the why before I go much further.

It is, of course, axiomatic that no dispute can arise unless there is a taxpayer who has done something: quite obviously, someone who does nothing, but just lies there like an amoeba, is not going to be in dispute with HMRC.

So, before a dispute can arise, there must, as a minimum, be a person who is adequately connected to the UK tax system (most typically a UK resident) who has done something capable of attracting liability to tax.

Now, broadly speaking, the things a taxpayer might do can be divided into three categories which, in ascending order of risk, can be described as the Routine, the Efficient and the Adventurous which might, these days, be more accurately described as the Stupid.

What I have called the Stupid or the Adventurous is something which is mass marketed as a way for the butcher, the baker, the banker, the candle stick maker and anybody else to avoid or to reduce tax and which very often comes with an apparently reassuring guarantee of free litigation, though it needs to be understood that the guarantee is of litigation, not of freedom from cost.

Schemes of this sort – tax avoidance schemes - are, these days, more or less doomed to failure and there is no point in doing them unless you particularly want a dispute with HMRC so that you can be moved up the risk rankings with a view to changing relations with your CLM.

Whether it is right or wrong that the law and public opinion should have got into a state where adventurous things are

doomed to fail and those who have undertaken them are sentenced to public ignominy are, no doubt, matters that can sensibly be debated.

But what cannot be debated is that that is the state things are in: nowadays, if you want to do something purely to save tax, something which has no commercial purpose or economic effect, the sensible advice is “Don’t” and there really cannot be much doubt about that.

What there can be more room for debate about is whether the things I have called Efficient can be, and are, nowadays, regarded as, Adventurous or Stupid and, in order to explore that question, I need to say more about what I mean by Efficient.

Efficient things are those which have a commercial purpose but which can be carried out in a way which will bring with it, as an incident, some form of relief from tax or some freedom from tax.

Examples of the kind of thing I have in mind are carrying out a disposal of a trading company in a way which allows SSE to be obtained, or acquiring a company partly for debt in the expectation that, subject to the usual limitations, relief will be given for the interest accruing on the debt, or structuring debt in such a way that the effects of the BEPS rules are mitigated.

Not very long ago – certainly 10 years ago and, perhaps, until more recently - we used to take it for granted that efficiency in carrying on a business was not only permitted, but also encouraged, by the tax system.

However, partly because of pressure from ill informed politicians, who have, in turn, been inspired by ignorant left wing activists who have no understanding of what a tax system does or is supposed to do, the revenue have started to get more and more interested in challenging the search for efficiency and this is the area in which most of us here will have experience of an increase in tension between HMRC and taxpayers.

The routine things done in the course of carrying on a business – the things done without any thought about tax at all – ought not to cause any dispute with HMRC, but the complexity of the tax system nowadays and the hunger of some revenue officials to raise challenges is such that even the routine does not always go without challenge.

Once you have a taxpayer who has done something, whether it be routine, efficient, adventurous or stupid, there is an engagement between the taxpayer and the tax system, between the taxpayer and the State.

Now, until comparatively recently we used to think of tax as, in a certain sense, voluntary: of course, we knew that we had to pay it, but there was no real sense of obligation.

However, I suppose things began to get more obligatory in 2004, when the DOTAS regime was introduced and the requirements imposed on a taxpayer have been growing more and more stringent since then.

Quite apart from these developments, a taxpayer who has done something, has always had an obligation to report what he has done to HMRC by a certain time and in a certain way.

An important point about returns is that the way in which they are made can limit the time HMRC has to open a dispute and also reduce the risk of penalties.

It is, of course, well known that HMRC have a period of one year in which to open an enquiry into a return delivered in time (FA 1998 Sch 18 para 24) and, if they don't open an enquiry within that period, they can only then challenge a person's self assessment if they can show that, putting it broadly, they could not have raised the challenge earlier because of an act or omission of the taxpayer, so that it was the taxpayer's fault, rather than theirs, that an enquiry was not opened in time – FA 1998 Sch 18 paras 43 to 45.

Moreover, there are further time limits which preclude HMRC from making challenges outside the enquiry window

and after a certain time which are dependent on the taxpayer being honest and not careless – see FA 1998 Sch 18 para 46.

It follows from all this that any large company putting in a tax return will need to think about the following questions:

- a. has the senior accounting officer (FA 2009 Schedule 46) complied with his or her obligation to ensure that his company's tax arrangements are fit for purpose?
- b. has the return made full disclosure of everything necessary to disclose to make sure that, unless they have opened an enquiry in time, HMRC will not be able to challenge the company's self assessment after the enquiry window has closed?

In relation to this question, taxpayers often wish to strike a balance between the risk that disclosure will invite unnecessary enquiry and the risk than non disclosure leaves things open for longer than necessary.

- c. has the return been drawn up carefully and honestly, so that HMRC will not be able to claim penalties for careless or deliberate error under FA 2007 Schedule 24?
- d. has the return been accurately drawn up so as to ensure that late payment penalties under FA 2009 Schedule 56 will not be payable?

Consideration of these issues at an early stage will limit the scope for dispute with HMRC, but it does not eliminate it altogether.

If a company has done only routine things it is, perhaps, unlikely that it will get an enquiry though, even then, it is certainly not impossible.

Conversely, if a company has done adventurous or stupid things, an enquiry is more or less inevitable although some people, oddly, manage to get away without one.

It is in the middle ground of the efficient transaction that the most change has been seen: HMRC used not seriously to challenge what I have called efficient transactions but now,

very often, they do and, quite often, when they do, they raise the question of penalties early in the debate.

As a general comment, it is quite obvious to me that the question of penalties is usually raised long before HMRC can have any idea at all whether a penalty is in any way appropriate.

In my view, HMRC are, these days, using penalties as a threat and as a negotiating tactic and, accordingly, in a way which is inappropriate and perhaps even improper.

A question which accordingly arises is how to react to the threat of penalties and I shall have more to say about that shortly, when I consider how an enquiry from HMRC is best dealt with.

However, I mention at this stage that I have had some success in countering HMRC's threats of penalties by relying on the Protection from Harassment Act 1997 which prohibits harassment and provides for criminal and civil sanctions for breach of the prohibition.

The Act applies to the Crown and defines harassment to include alarming a person or causing the person distress – and making a premature or unjustified claim to penalties certainly does that.

Another general comment that I might make is that when people come to see me about a dispute, they are self evidently in a dispute with HMRC.

It is possible that this gives me a somewhat unbalanced view of how relationships between HMRC and taxpayers are: just as a cancer surgeon, who sees patients only once they have been diagnosed with cancer, might get the impression that everybody will get cancer, so it is possible that I am given the impression that everybody is in dispute with HMRC.

However, not everybody I see is in dispute with HMRC, so that I do not think that I am suffering from an unbalanced view of things: I believe that there are now many more disputes between HMRC and taxpayers than there used to be.

Because the potential for dispute exists, it is necessary to prepare for it from the earliest possible time.

Now, of course, nobody doing what I have described as a routine thing is at all likely to have taken advice about it from anybody who has anything to do with tax: it will just have happened and, in a sense, the absence of advice about it is a hallmark of its innocence, something which may help to protect it from enquiry, though even innocence does not provide a guaranteed protection from enquiry.

Conversely, anybody thinking of doing something effective or stupid is almost certain to have taken tax advice about it.

As the advice in relation to the Stupid should have been “don’t”, it is unlikely that anybody here will be dealing with enquiries relating to the Stupid and so I shall not cover an enquiry of that type: that means I shall not deal in any detail with Follower Notices or APNs which are means of collecting money before HMRC have made a formal claim to tax; enforcement action of that kind should not be relevant in cases which aren’t in the Stupid Category.

Again, then, the type of enquiry on which to concentrate is that conducted into the effective.

Now, disputes do not arise because there is a requirement imposed on HMRC to have a dispute, nor do they arise by accident.

They arise because HMRC want to have a dispute: in relation to what I am calling efficient transactions, the creation of the dispute will always be a matter of choice on the part of HMRC.

A problem nowadays is that HMRC are looking to have more disputes than used to be the case.

It is this willingness to dispute which may make it right to characterise HMRC as an enemy and it is what makes it essential, when arranging what is to be done, to bear in mind that a need to defend it robustly might arise: indeed nothing effective should be done nowadays unless it is understood that

an enquiry into it is likely to be opened and the taxpayer is prepared to face the enquiry.

It needs to be remembered in this context that an enquiry may well lead to an amendment of a self assessment and to an appeal against the amendment.

Because that is so, nobody should do anything of the kind I am describing as effective unless they are willing to fight to uphold its effect.

On the appeal, the burden will generally always be on the taxpayer to show that his self assessment is right (the position is different if HMRC begin their enquiries only after the enquiry window is closed) and it follows that, from the inception of anything which is influenced by tax, the taxpayer should be thinking about how he will show that his self assessment was right.

That means that he will need to show what he did and, very often, why he did it.

It is, accordingly, necessary from day one of the thinking about the efficient thing to be done, to consider how the what and the why will be proved.

One thing that very often happens when the time comes to defend something which has been done is that there is nobody left in the company who can give evidence about something which may have happened years before.

The risk of that happening is, of course, ever present but it can be mitigated if thought is given at the planning stage to who should be involved and who will be able to give evidence later.

So the possibility of enquiry needs to be thought about from inception: thought needs to be given to the paperwork and it needs to be borne in mind that HMRC will almost certainly ask to see it and that it is not a good idea to say “No” even if one can.

The reason why it is not a good idea to say “No” to HMRC’s request for paperwork is twofold.

First, HMRC have enormously wide powers to get information under FA 2008 Schedule 36, so that there is generally little point in refusing production.

Secondly, HMRC will understandably assume that there is something in papers which you refuse to produce which you do not want them to see.

Whether that is true or not, HMRC will be much much more interested in things a taxpayer does not want to produce than they will be in things they are given without argument: refusing to give HMRC things for which they ask will needlessly increase the intensity and heat of the battle leading to a loss of focus and light.

In thinking about the paperwork to produce to reflect the transaction there is a balance to be struck between creating documents sufficient to establish the what and the why of a transaction and the wish not to create documents which might be embarrassing: I would prefer to err on the side of producing documents.

In particular, if there is a tax benefit which, it is hoped, will be obtained from a transaction, it is usually best to recognise its existence and to explain its subsidiary context rather than to pretend that it does not exist: a skilled reader of company documents will generally be able to tell when part of a story is omitted and omissions can be much more significant and harmful than the true story; an omission is nearly always a confession of guilt.

Another point people sometimes stress about is privilege, which protects a much more limited class of document from disclosure than is generally realised and which, in any event, should not be relied on.

The reason why it should not be relied on is that relying on it sends the message that there is something harmful to the taxpayer in the document for which protection is sought, and that message is likely to be far far more damning than anything in the advice.

After the efficient thing has been done, there will be the need to make returns and to think about the issues I outlined earlier.

And, after the returns have been made, the waiting will begin: will HMRC open an enquiry within the enquiry window?

I rather think that with large companies, which tend to conduct quite open relationships with HMRC, it is most likely that the dispute will begin with HMRC opening an in time enquiry into the company's self assessment.

Now, HMRC's conduct of the enquiry is governed not only by the specific (but limited) rules about enquiries in TMA 1970 and FA 1998 Sch 18 but also by the general rules of public law: HMRC must not behave irrationally or oppressively; they must not act with a collateral motive, they may not do anything which they do not have power to do and they must treat all taxpayer's alike.

It is notable that, while HMRC are entitled to more or less full disclosure from the taxpayer, the taxpayer is not given an equivalent right to disclosure from HMRC.

That makes it difficult to know whether you are being treated in the same way as another taxpayer and getting information from other taxpayers or from the revenue to aid in a claim of unequal treatment has proved far from easy.

Indeed, the general public law limitations on HMRC's conduct are unlikely to be useful where HMRC are just carrying on an ordinary enquiry which was begun in time; there may be more scope for relying on public law remedies where an enquiry has been begun after the enquiry window has closed; but where the enquiry was begun in time there are two reasons why the general rules of public law are unlikely to be of use to a taxpayer.

The first reason is that the statutory power to enquire given to HMRC is not circumscribed in any way and, in particular, it is not, circumscribed by rules about the extent to which the enquiry may be taken nor, subject to one rule which I shall explain shortly, circumscribed by time.

Accordingly, the power to enquire is one which it is difficult to control using public law remedies because it is so very wide.

The second reason why the power to enquire is not apt for control by general public law remedies is that the taxpayer is given, by the legislation, two specific ways of dealing with an enquiry; and there is a general limitation on the ability to get a public law remedy which is that, where legislation provides for a specific way of dealing with a matter, the existence of the specific way of responding usually excludes the general law remedies.

The two specific ways of dealing with the enquiry relate to different times in the enquiry process.

An enquiry is brought to an end by the issue of a closure notice and a closure notice must specify either that HMRC accept the self assessment made by the taxpayer or that HMRC have reached certain conclusions affecting the self assessment which require amendments to be made to it and, in that case, the closure notice must amend the self assessment so that it makes a claim for a specified amount of tax – see FA 1998 Sch 18 para 34.

There are also similar provisions which allow for a partial closure notice to be issued.

Now, once HMRC have opened an in time enquiry, the taxpayer's affairs are put in to limbo: HMRC have not accepted the self assessment as right but, equally, they have not asserted that it is wrong and this limbo state lasts until the closure notice has been issued.

Not many people enjoy the limbo state: it is, after all, a form of purgatory; you do not know whether you are in the heaven of an agreed self assessment or the hell of being told you are wrong.

The first specific remedy given to the taxpayer in the context of a continuing enquiry is to ask HMRC to conclude the enquiry by issuing a closure notice and, if they won't do that, the matter can then be referred to the Tribunal which can order the issue of a closure notice.

However, the Tribunal will only order the issue of a closure notice if it is satisfied that HMRC do have enough information to reach a conclusion and so, persuading a tribunal to order a closure notice can be quite difficult if HMRC are saying that they aren't in that position.

The second specific remedy given to taxpayers arises once a closure notice has been issued amending a self assessment: the taxpayer may then appeal against any conclusion expressed in or any amendment made by the closure notice.

I shall talk about what happens on an appeal shortly but let me now return to the stage at which HMRC have just opened an enquiry.

Sooner rather than later, HMRC will explain the point they are interested in and, at this stage, the probability is that everyone on the taxpayer's side will be optimistic that they are going to get this sorted out and a letter will be written explaining why the self assessment submitted was correct and needs no amendment.

Now, once upon a time, not that long ago if we were dealing with an enquiry into something routine or efficient, we could reasonably have expected the letter explaining things to lead to a speedy resolution of the matter, to agreement that the self assessment was correct.

But the level of aggression has risen now and some things which, when they were done, might have been regarded as efficient might now be regarded as adventurous (I have in mind the scheme for mitigating tax using corporate partners in fund management partnerships which seems adventurous now) and, anyway, HMRC now has a greater appetite for disputing efficient things than they once had.

It is likely now that the first letter of explanation will not lead to the hoped for rapid resolution: the overwhelming likelihood nowadays is that HMRC will write back and say something like "Thank you so much. That is very interesting

and helpful but we are ever so politely going to ask for a bit more information. For example, could you let us have every single thing which shows exactly why you did this thing into which we are enquiring”.

The question is what to do in response to that kind of reply.

Broadly speaking, the response can be softly softly or it can have a bit more steel in it. There is no right or wrong way of responding and the choice must be made according to the taste of the taxpayer in question.

Now most large companies do not want to get too aggressive and anyway there is no point at this stage in getting difficult because, as I have explained, a refusal to disclose is bad psychology and, in any event, pointless.

So the probability is that what at least appears to be a fulsome and willing disclosure will be made and, on the taxpayer's side, the hope will still be that an agreement can be reached and matters be resolved.

And HMRC are likely to reply saying that they are ever so grateful but could they please just have a teeny bit more information and at this stage, they might lightly introduce the idea that there could be penalties if the taxpayer doesn't give in – and this is the danger point.

Everything will, at this stage, seem more or less lovey dovey and there may be a belief that with just one more heave we shall get out of danger into safety.

Make no mistake that is wrong: no matter how smiley HMRC may seem at this stage, you are looking at a crocodile and it is at least sometimes if not always wrong to smile back.

The General had made the mistake of smiling at the crocodile: he had not been eaten at the stage he came to see me, but he had been sucked into the fiscal bogage in which HMRC did nothing to resolve the matter but went on asking for more and more irrelevant information, a process which sucks the energy and life out of people until they have no will to continue.

The right thing to do once you have provided all the information that there is about the transaction – but only once you have done that – is to stand to your tackle and put up a fight.

The right thing at this stage is to say to HMRC “you have had all the information you can reasonably require. Now either issue a closure notice so that I can (as I shall) appeal or shut up”.

And, by the way, if penalties have been raised as a possibility, the suggestion needs very rough handling and the sooner the better.

I have no doubt whatever that asking for a closure notice is the right thing to do at this stage: it shows a willingness to fight; it shows confidence; it shows spunk and belief in your case.

Of course, nobody actually wants to go to an appeal hearing.

But I guarantee you that the best way of avoiding a hearing is to say that you want one: I guarantee you that once you demand a closure notice, HMRC will start to say that they are not in a position to give you one.

Of course, HMRC will still try to give you the runaround, but you will have seized the moral high ground.

Until HMRC’s settlement and litigation strategy was brought into force, taking the moral high ground and battering HMRC from there was a more or less certain way of achieving a favourable resolution of the matter.

The ludicrous settlement and litigation strategy and the introduction of HMRC’s internal governance procedures which involve the use of the TDRB has made reaching a sensible agreement much much more difficult than it used to be, but that only sharpens and reinforces the need to be prepared to fight.

After all, if it is not going to be possible to settle a matter because HMRC say that the settlement and litigation strategy precludes it or the TDRB prohibits it, the choice is between fighting and giving in and, if you are going to give in, what is the point of having started?

It seems obvious to me that, if you have done a transaction

you believe in, the rational choice is to say that you are going to fight and then to pursue a course of action which shows that you will do that as soon as complete disclosure has been made.

Although that is the rationally correct thing to do, most taxpayers don't want to do it: they cling to the receding hope of settlement in the belief that, if they beg enough, HMRC will give in and, anyway, who wants to go to war even if the form of war is, apparently civilised litigation?

I understand that approach. I have had clients adopt it. I have never seen it succeed. Never.

Of course, I cannot say that it never succeeds: I can only say that I have never seen it succeed; HMRC do not respond to the importunings of taxpayers any more than women respond to men's tears.

Once the correspondence has reached the stage I have been dealing with, it will continue in one way or another until one side gives in (that is not usually HMRC in cases where the non firm approach is adopted) or the taxpayer lodges and starts to prepare an appeal.

Before I go on to consider what happens on an appeal, I should make three points about discovery assessments – claims to tax made for the first time outside the enquiry period.

First, there may be more scope for challenging what HMRC are doing in making discovery assessments on general public law grounds than there is for challenging HMRC's conduct in relation to enquiries.

Secondly, HMRC generally carry the burden of establishing that they are able to make a discovery assessment – that is, they must establish that there was fault on the taxpayers part which prevented HMRC from making the claim within the enquiry window.

The first two points together mean that there may be scope to challenge the validity of a discovery assessment than there is to challenge what is done as a result of an in time enquiry.

Thirdly, because of the second point about burden, it is worth thinking about who should open the appeal: in tax appeals it is usually the taxpayer who should open but, where HMRC carry the burden, there may be a lot for saying that HMRC should open.

In all cases, whether arising as a result of an in time enquiry or an extended time discovery assessment, there will, by the time an appeal is lodged, be a claim document: it may be a closure notice or a discovery assessment but there will always be a document which makes a claim.

It is always worth examining this document closely: it may contain procedural or substantive defects; it may limit the points HMRC are allowed to raise on appeal.

However, assuming the claim is validly made, the matter will, if a taxpayer has decided to fight, go to appeal and I should say something in conclusion about how an appeal is likely to go.

We tend to think of law as quite a hard wired subject, a bit like arithmetic where, I am led to believe 2+2 always equals 4.

However, those judges who have written about how they decide cases tend to emphasise two points.

The first is that law is very plastic: no sooner have we drawn our lines, said one famous US judge, then we start to rub them out and blur them.

The second point is that “dirty dogs don’t win cases”, a point expressed in that way by Lord Browne-Wilkinson, which tends to emphasise the epigram of US litigators, which is that, to win a case, you must “capture the merits and stick the capture”.

How do these points apply to tax cases?

Here in the UK, until about 40 years ago we read the statute more or less literally and, if it did not impose tax, we did not read it as imposing tax: the statute was applied in a very inflexible way.

However, starting with the 1980s, attempts to avoid capital gains tax met with a hostile response from the Courts: the law became that tax avoidance schemes do not work.

Now, the rule as I have just put it was expressed that way only in one First-tier Tribunal case and you will not find the matter expressed that way in any case of significant authority.

Since 1982, the House of Lords has expressed the position in different ways in different cases but I think the generally accepted form of the rule today is that you “apply the statute, construed purposively, to the facts viewed realistically” – and aphorism originally framed by Ribeiro PJ in *Arrowtown* and since then widely adopted as the true position.

It will be seen that this way of looking at things creates a very flexible position: construing purposively allows the Court to give a statute a meaning it does not naturally have while viewing the facts realistically allows the Court to decide that the real facts are different from the facts as they appear to be and that can, for example, allow the Court to ignore things which have actually happened.

The question which then arises for any taxpayer who has undertaken an efficient transaction is whether the Court is going to apply the law so as to strike down and render ineffective the tax benefit which, it was hoped, would be obtained as a result of the efficient transaction.

Certainly, the law now has in it sufficient flexibility to allow a Court to do that, but that does not mean that the Court will do that.

Here, the second point of judging comes into play: the question is “who is the dirty dog?”

I suggest that, where a transaction has been driven solely by a tax motive, the taxpayer will be seen as the dirty dog and will lose.

But where there is a commercial reason for a transaction (and particularly where a judge could see himself doing the same kind of thing personally) I believe HMRC will be seen as the dirty dogs and will lose a case.

In short then, the outcome is going to depend on being

able to show the commercial purpose: if the transaction would have been done if tax had never been invented, it should bring with it any hoped for tax benefit.

I remain steadfast to the belief that tax benefits incidental to inherently commercial transactions should and will be obtained.

However, obtaining them requires toil and sweat: it requires the willingness to fight; if you sit taking the pounding the enemy is giving you without fighting back as the General, with whose story I began, had been doing, you will never escape from the bocage.

But you are not without weapons. There comes a time when you must manoeuvre them into position and start firing back: in that way, you should be able to escape and, indeed, by bringing an appeal, counter attack.

In my experience, the sooner the taxpayer does that, the better.