Analysis

The art of mediation

Speed read

Mediation as a means of resolving commercial disputes involving tax has been around for ages but has only come to the fore in disputes with HMRC in the last six years or so. In tax disputes, mediation is used in two separate contexts. First, there are tax disputes that do not involve HMRC, at least not directly in the sense that HMRC is not a party to the dispute. Examples of such disputes include disputed tax liabilities arising out of the tax warranties and indemnities given by the parties to each other on the sale of a business or a company; and also disputes as to liability for negligent tax advice where a client is claiming against his tax adviser for bad tax advice. The second context is where a taxpayer and HMRC are seeking to avoid litigating their dispute before the tax tribunals and the courts by relying on mediation to achieve an agreed outcome to the dispute.

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The basics of mediation

Mediation is a deceptively simple concept and mediators play a deceptively simple role in helping the two participants reach a successful resolution of their dispute. The role of a mediator requires the mediator to adopt almost the opposite of his role as a barrister, solicitor or accountant representing a client in a tax dispute. When representing one side in a dispute, the adviser will naturally be taking a positive role in advancing his client's strong negotiating points, while vigorously defending and trying to minimise his client's weaker points.

A mediator will on the other hand strenuously avoid taking sides or doing anything that could be construed as supporting one participant against the other. Mediators are there to facilitate an outcome that each participant agrees and to assist the participants to get there. While mediators can assist the participants with matters of process, they cannot give legal or tax advice. In a tax mediation, however, it is obviously helpful for mediators to have a tax background so that they can understand the issues at stake and follow the technical discussion and tax issues between the participants.

A mediation is usually set down to take one day and at a time and place agreed between the participants. The mediator selected will have been agreed by both participants, and the appointment is governed by a simple mediation contract which is signed by both participants who share the cost of his fee. Experience suggests although most mediations are set down for eight hours, they actually end up being resolved in four or five hours.

In a tax mediation, it is sometimes the case that an agreement is reached in principle on the disputed points but that once this has been done, detailed computations will still need to be made. The contract of settlement reached at the end of the mediation day should make provision for who will do this, and how and by when it will be done, with provision to come back to the mediator if there is any disagreement about the figures. Experience suggests that having successfully arrived at an agreed compromise, the participants are usually reluctant to prolong the agony of the dispute by falling out over the detailed computations.

A good mediator will ask for and read the case papers sent by the participants in advance and ask any questions that might help to understand the finer points in dispute. The participants' legal or other professional advisers will often attend the mediation with the participants and they may play an active role in the mediation hearing. However, an experienced mediator will be alert to the possibility that the lawyers for one side or the other may have a financial or other interest in prolonging the dispute. Sometimes, if the principals can meet during the mediation day without their lawyers, a settlement may stand a better chance of being reached.

Mediators can be drawn from a range of backgrounds, including solicitors, barristers, dispute resolution teams at professional advisers and established mediation organisations. The skills, experience and technical understanding brought by the individual mediator will be highly significant when it comes to selecting the best mediator for your requirements, while it is worth noting that the cost of different mediators is also likely to vary significantly.

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Are the two contexts similar?

While a mediator will bring the same mediation skills and techniques to bear in each type of mediation, a mediation between HMRC and a taxpayer and a mediation between two commercial or private parties to resolve a private dispute are fundamentally different animals. The mediator and the parties to a dispute involving HMRC need to be acutely aware of the issues that are unique to a mediation involving HMRC. These issues tend not to arise in the context of a private dispute where the parties are largely free to settle on whatever terms they feel are appropriate, subject to any settlement agreement not being unlawful or involving any illegality.

HMRC mediations and their limitations

The issues that arise in a mediation involving HMRC turn on the fact that it is a non-departmental government agency designed to administer and enforce tax law and efficiently collect tax revenue. The role of HMRC therefore imposes constraints on what HMRC can agree to in a mediation. A good mediator will be alive to

these constraints and will advise the parties in matters of process, as opposed to advising them on substantive matters. The mediator should assist them to avoid the pitfalls that might result in the settlement agreement being unpicked by HMRC later on.

The constraints on an HMRC mediation were illustrated in the case of *The Serpentine Trust Ltd v HMRC* [2018] UKFTT 535 (TC), which followed the partial settlement of a tax dispute with HMRC by mediation. In an agreement reached between the trust and HMRC at the end of a mediation in July 2013, HMRC had agreed on the future VAT treatment of the trust's charitable receipts. However, no agreement could be reached on the VAT treatment for prior periods and in respect of those periods the trust later took its appeal to the tax tribunal and lost. In the trust's appeal in 2014, the tribunal commented that although the parties had agreed the position in relation to future periods, this was 'wrong in law' and 'inconsistent with [HMRC's] published position'.

HMRC can only enter into a legally binding contract that governs its future powers to collect tax in very restricted circumstances

In 2015, HMRC then changed its view and resiled from the 2013 agreement for future periods by issuing assessments that differed from the basis on which the VAT treatment had been agreed in 2013. On the trust's appeal to the tax tribunal against the assessments, the tribunal had to decide whether the 2013 agreement was in principle a binding contract; and if so, whether it was void because of a mistake by HMRC or because it was wrong in law and was therefore outside of the powers of HMRC to make it. The tribunal decided that the 2013 agreement was a contract; however, taking into account the Commissioners for Revenue and Customs Act 2005 and the relevant case law, what had been agreed by HMRC in 2013 was 'wrong as a matter of law' so that the contract was outside HMRC's power to make and so was void.

This shows that HMRC can only enter into a legally binding contract that governs its future powers to collect tax in very restricted circumstances. HMRC has the legal duty to get the best return for the Treasury and to protect the revenue. This duty prevents HMRC from entering into contracts that would prevent it from taking into account future legal changes, or changes in the circumstances of taxpayers. This means that agreements with HMRC cannot be binding for a specific future period or be irrevocable. The tribunal held that HMRC cannot legally put itself in a position that would stop it from enforcing a taxing provision except 'in circumstances where the reason for that concession is for the purpose of HMRC's overall task of collecting taxes'.

What can go wrong?

The HMRC mediator in the *Serpentine Trust* mediation was criticised by the tribunal judge for being an unreliable witness. This was probably unfair, given that it had been five years since the mediation and, like most mediators, he had probably made a point of not keeping any papers following the end of the mediation. However, the mediation agreement reached at the end of the mediation sought to bind HMRC into accepting a position for future VAT periods that was contrary to its policy and which the 2014 tribunal decision found to have been wrong in law. This was not necessarily the mediator's fault as he was not experienced in this technical area, and in any event it was not his role as mediator to give technical advice. The mediator was there to use his mediation techniques to facilitate the participants in arriving at a settlement.

It is the responsibility of the participants and their legal advisers to ensure that they enter into a settlement that is within the powers of each side to enter into and is not void. In any HMRC mediation, the parties ought to be familiar with HMRC's litigation and settlement strategy, which sets out the framework through which HMRC is supposed to settle tax disputes, and the case law governing HMRC's legal powers and the scope of its discretions. Having a mediator who is familiar with these things is obviously desirable. Although the mediator is not there to give legal advice, a good mediator will find a way to alert the participants using his power to advise on 'process', which in these circumstances involves assisting the participants to avoid the perils of entering into an unenforceable settlement agreement.

Tax mediations not involving HMRC

Tax mediations not involving HMRC do not normally suffer from the same types of limitations described above. However, where companies are concerned, it is important to ensure that the participants do not exceed their corporate objectives or otherwise act ultra vires, such as purporting to contract out their obligations under the taxing statutes.

Mediations are being used more often in relation to professional negligence claims, including those involving tax. Claims against advisers for negligent tax advice are on the rise, especially since the Court of Appeal's ruling in *Barker v Baxendale Walker Solicitors* [2017] EWCA Civ 2056, and often involve a combination of different taxes arising out of the same transaction. These can be particularly complicated and once the adviser's insurers are involved become particularly hard fought with the insurer's lawyers usually seeking to wear down the claimant with lengthy and expensive manoeuvres designed to put off the claimant.

These cases are especially appropriate for mediation. Typically, once the parties to the dispute have fought each other through to the case management and costs management conferences before the master, and are facing, say, a ten day High Court action and the risks of costs that this entails, they are in the mood to explore alternative dispute resolution and seek to settle via a one day mediation. ■

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