

## The good, the bad and the ugly

*In the second of a three-part series, Gary Brothers talks through some of the cases his firm has taken through the Alternative Dispute Resolution process*

In my first article featured in the previous edition of this magazine, I talked about the availability of HMRC's Alternative Dispute Resolution (ADR) process to help settle direct and indirect tax disputes. I covered when and how to apply for ADR, as well as how to prepare for the meeting itself.

During this follow-up article I'll talk through some of our cases, where the Opening Statements had been shared beforehand and the meeting arrangements agreed. Some went well ('the good') and some less so ('the ugly') – but we learn from our experiences, so hopefully they will still be helpful to any readers.

### The good (three cases)

#### Case 1

This case involved a manufacturing company heavily involved in the motor vehicle sector. The company had made a research and development (R&D) claim (oh no, I hear you cry...) involving five separate projects. All the projects involved the manufacture of parts to help in the move from fuel combustion engines to battery powered electric versions.

HMRC had launched an enquiry into the company tax return containing the claim and sought the usual documents and information to test whether a qualifying advance had been made in each project.

Initially, the specialist R&D firm who had prepared the claim sought to handle the enquiry themselves and provided the HMRC officer with detailed paperwork and explanations, both in writing and over the telephone.

However, as time moved on, the working relationship between the HMRC officer and the specialist R&D firm broke down and became, I think it is fair to say, distrustful. The HMRC officer expressed his intention to issue a Closure Notice for the accounting period involved, in which the R&D claim would be denied, thereby creating a big tax bill for the company.

Matters became more complicated when the Closure Notice failed to materialise, despite the HMRC officer insisting one had been issued. The officer said he could not produce a copy of the Closure Notice and, indeed, failed to produce one at all.

The company approached Independent Tax, the day before the expiry deadline for appealing against the Closure Notice and asked for our help.

As you would expect, we acted quickly to obtain copies of the correspondence prior to our appointment and manage to prepare an in-time appeal – it was a close call but we got there.

The HMRC officer accepted the appeal as competent, remained 'open' and subject to disagreement, so the Closure Notice remained open.

The director of the company then needed to decide what to do next. The specialist firm had hit a dead end, both in terms of what they could provide to HMRC and in its working

relationship with the officer. The company's regular accountants, whilst happy to assist where possible in the background, were unwilling to take the enquiry on themselves.

My company, Independent Tax, was then engaged by the company to take over the enquiry.

As is common with most R&D enquiries, the HMRC officer was critical of the baseline of the projects and was unconvinced advances had been made.

We provided what further written explanations we could and even provided diagrams and sketches in support, to try to help the HMRC officer understand the projects fully. Frustratingly, and true to current form, he remained unconvinced. From there, the inevitable Review Conclusion letter supporting the HMRC officer's position followed, and so we applied for ADR.

Helpfully, a former director who had been running the company at the time of the R&D projects, agreed to come out of retirement to help us. We had several meetings with him and discussed ways of helping HMRC comprehend the projects. We prepared him thoroughly for the ADR meeting, mainly in terms of asking him to refrain from using technical jargon that might confuse HMRC and to explain the projects in the simplest terms possible, referencing pictures, diagrams and the like.

As the HMRC officer had been unable to grasp the projects through written and telephone explanations, we asked the retired director whether he could use visual props to help demonstrate the advances. He agreed and, after he had found some suitable parts, we had a final run through before the actual meeting itself.

The prevailing norm with ADR meetings is for all the attendees to log in remotely, but Guy Smith, one of our Senior Managers who had been handling the case at Independent Tax, decided to travel to sit with the current and retired directors to offer practical support on the day.

The thorough preparation paid off!

The retired director talked through the projects in a confident and knowledgeable manner, with us providing immediate support when required to clarify explanations where necessary.

The HMRC officer was finally persuaded to accept an advance was made, in all five projects, subject to further costs information being provided. That information was subsequently provided and the claim allowed in full.

The retired director told Guy at the end of the meeting that he did not know how he could do this work, day in day out. 'It's so stressful' he exclaimed!

## **Case 2**

In a different case, we represented a very observant Muslim client at ADR who had received a capital gains assessment. His religion was pertinent as he had remortgaged his entire buy to let property portfolio from a 'conventional' High Street lender to a Sharia law compliant Bank. His reason for doing so was purely to comply with his faith.

When he had mortgaged his properties to begin with, he had been unable to find a suitable Sharia mortgage product on the market from the traditional lenders, but when the time to remortgage arrived there was such an option open to him and he took it.

The mortgage product he moved to did not offer a better rate, or a cheaper monthly payment, but as the leader at his local mosque he felt it was important to meet a key Sharia principle, in not paying (or receiving) interest.

A traditional mortgage typically sees monthly payments of capital and/or interest which gradually repay the amount borrowed to the lender. Crucially, the borrower retains ownership of the property.

However, with a Sharia law compliant mortgage, the ownership of the property reverts to the lender and monthly repayments of rent are made by the borrower instead. HMRC latched on to this change of ownership and decided a partial disposal had taken place for capital gains tax purposes. The 'gains' were substantial, in the millions.

We appealed against the assessments and took the fight to HMRC, highlighting the potential discriminatory action and the failure to apply the 'level playing field' so actively pursued by the government.

We sought help from and met with senior figures from two prominent Sharia-based lenders, who provided supporting correspondence and numbers. We also approached MPs from both the main political parties and were invited to attend the All-Party Parliamentary Group on Islamic and Ethical Finance. This all added to our case as, by the time the ADR meeting arrived, we had gathered a substantial library of evidence to present to the HMRC officer and line manager, who was also in attendance. We and the HMRC officer had a constructive conversation, with the officer agreeing to look at the technical arguments again. We also brought HMRC up to speed on our conversations with the banks and MPs.

HMRC accepted the legislation was likely to change and agreed to an extended stay with the Tribunal, until matters had played out.

As it transpired, HM Treasury launched a consultation on Alternative Finance and new legislation was introduced with effect from the day of the Autumn Budget. Unfortunately, the legislation was not backdated and our very own Guy Smith had to lobby the Treasury and HMRC again to apply the legislation retrospectively. Eventually, HMRC wrote to the Tribunal and withdrew their opposition to the appeal against the assessment. We saved the client over £1m in tax, penalties and interest.

This time ADR had not directly resulted in a settlement, but it had provided the forum for a more wide-ranging discussion of the facts, not just relating to technical tax points and opened the door to ongoing discussions aimed at a non-Tribunal resolution.

### **Case 3**

In a third case, a restaurant on the south coast had been the subject of an HMRC enquiry for eight years, before we were engaged to help. We were the third advisor to be appointed.

This was a particularly tricky cross-tax enquiry, made more difficult by the fact the owner had been under enquiry before and had paid a substantial settlement. HMRC believed he had continued in his non-compliant ways by under declaring his restaurant sales. Furthermore, HMRC were insistent that his behaviour was deliberate and were looking to penalise him heavily.

We applied for ADR to try to find a way forward.

The previous advisers had tried different tactics to try to settle the case earlier, offering various uplift percentages, even linking the percentages to housing development around the restaurant.

The ADR meeting saw four attendees from HMRC. The corporation tax inspector, a VAT inspector, a line manager and an HMRC officer specialising in deliberate penalties.

HMRC were looking for circa £1.5m at the outset of the meeting, before intense negotiation ultimately led to a settlement closer to a quarter of that.

As often the case, HMRC relied on the test meals they had consumed in the restaurant and their analysis of potential missing meal bills at the end of their invigilation. We fought back in the ADR by identifying errors in HMRC's invigilation notes, quoting meals that were not even on the menu.

The important error HMRC had made in their calculations was a failure to recognise that the restaurant had extended into the premises next door. HMRC had scaled back into the earlier years assuming the same number of covers and takeaways, when the original premises were much smaller. We also had an argument about whether the kitchen could actually produce the number of meals estimated in the tax and VAT assessments.

The ADR meeting lasted a whole day and did not finish until after 6pm, but we achieved a great settlement for the client.

Unfortunately, not all our cases which have passed through the ADR process have been successful.

## **The bad (two cases)**

### **Case 1**

This case particularly frustrated me and I let my feelings be known to HMRC. The case involved goodwill and we had an ADR meeting with the HMRC officer and his line manager, although it quickly transpired that they were not in control of the case. Their absent colleagues in Policy Division were.

Seemingly, every time we raised a technical point HMRC asked for a break in the meeting to consult with their Policy Division colleagues. This carried for the duration of the ADR.

At one point, I asked for the Policy Division people to join the meeting as they were clearly in charge. The HMRC officer and line manager denied that was the case, but their body language and lack of ability to respond to our technical points gave an entirely alternative impression. Indeed, some might say it was less than candid.

The meeting ended with an agreement from HMRC for a different meeting to be set up with representatives from Policy Division. However, HMRC soon resiled from that agreement, apparently because Policy Division thought there was nothing further they could add at such a meeting.

So no agreement, but a complaint (successfully) submitted for the costs of the day and preparation given that the entire ADR had, we said, been doomed to fail from the start given HMRC's unreasonable approach. We were helped by the fact that even the (HMRC) ADR Facilitator agreed that our view was, likely, correct.

### **Case 2**

In another case, our client offered a without prejudice settlement to HMRC at the outset of the ADR meeting. The HMRC officer was interested, especially as it would have meant an end to a long enquiry. She had been the Inspector who had launched the enquiry, but two other colleagues had replaced her, when she moved on to other duties within HMRC before coming back.

Somewhat unfortunately for her, she found herself back on the case some time later and we could tell the offer appealed to her. Regrettably, Policy Division were also involved with this case and refused the settlement offer made in the meeting, even though HMRC would have received well over half the money assessed.

Neither our client nor ourselves could believe the rejection.

Perhaps it is a reflection of how HMRC do not consider settlements in commercial terms because time and cost does not enter the equation. HMRC officers are held at the high altar of the Litigation and Settlement Strategy and very rarely deviate from it.

### **The ugly (one case)**

We were rabbits caught in headlights in this ugly case and learnt a valuable lesson about planning for the HMRC attendees, as we were entirely ambushed on this matter.

HMRC had an army of officers lined up against our client for this ADR meeting, which had two key themes. It centred on the introduction of a property into a company pension scheme and whether HMRC were in time to raise an assessment, under the auspices of careless behaviour. The ADR had been prepared, entirely, as a penalty behaviour dispute – HMRC argued careless, we argued not (reasonable reliance on advisor).

Little did we know that HMRC would direct their fire at the accountant who prepared the company accounts and who had decided to attend the meeting to “help if I can”, despite our suggestions that he was best not attending.

The HMRC officers made no secret of their animosity towards the accountant involved and took him through some of his actions in the past. Whilst willing to accept that the company had not been careless, HMRC did not accept the accountant had not, going so far as to look at his behaviour as deliberate.

This was definitely the worst, most aggressive ADR meeting we have ever been involved with. It was quickly drawn to a close before lunchtime, as the atmosphere was so sour and poisonous. Lesson learned – ensure the HMRC Facilitator is crystal clear on all HMRC attendees and their roles, and then call it out if an ambush happens before your eyes.

### **Summary**

In our experience, ADR can definitely be worthwhile and we have had other successful outcomes, not just those under the above (the good), but many more. However, we do not win them all at ADR and there are some cases which can take a painful or unexpected turn – learn lessons from those experiences and beware that not all HMRC staff approach ADR in the spirit of compromise or reconciliation.

In my final article of the series I will focus on the lessons we have learned and provide some tips for a successful ADR process with HMRC.

In the meantime, my details are shown below if you wish to discuss any of your cases and need our expertise in this area.

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