What a difference a year makes: the changing tax disputes landscape

The last two years have seen many changes to the rules governing tax disputes and an expansion of HMRC's powers to tackle tax avoidance. The effects of these changes will be long lasting and wide ranging, not only for 'tax avoiders' but all taxpayers. What has driven these changes? Top of most commentators' list is the unprecedented pressure on HMRC to tackle tax avoidance (whether actual or perceived). The recent media coverage of different tax authorities' responses to the offer of using customer data to track down offshore accounts is simply the latest example of this. Other factors include the public reaction against large companies and wealthy individuals avoiding tax or otherwise not paying their 'fair share' and the consequent political responses (from all parties). The result of these changes can be seen in three key areas for the majority of taxpayers (and rather more for those who remain engaged in, shall we say, more active tax planning).

Removing the cash flow advantage

The first, and probably most noticeable, change is the way in which the new rules have largely removed any cash flow advantage for taxpayers in most tax disputes. For instance, the accelerated payment notice (“**APN**”) regime in Part 4 of the Finance Act 2014 (**FA 2014**) has already been used for transactions previously disclosed under the DOTAS regime – whether such transactions had a 'tax avoidance' motive or not. Likewise, one of the intended consequences of the proposed issue-based closure notices (see the consultation) seems to be to generate a greater number of HMRC-friendly decisions that can be used as the basis for follower notices (of which, more below). Most recently, the mechanics of the new diverted profits tax require payment upfront (at 25%) before taxpayers can dispute whether the new tax applies or not. Of course, in the UK the quarterly payment or VAT regimes have long required estimated amounts to be paid in advance and many overseas jurisdictions operate systems where some or all of the tax in dispute has to be paid upfront. Nonetheless, the new powers for HMRC represent a significant change in the way tax disputes are conducted in the UK (and one that means taxpayers and their finance departments must be ready to fund tax disputes at the outset).

In addition, these changes may prove to be relevant to those engaged in normal M&A activity (see box), thus illustrating how recent changes have effects beyond their original target.

The APN and follower notice regimes present new challenges for M&A tax advisers. The facts of each deal (and associated contractual protection) will vary but relevant considerations may include, for example, whether the target company (or group company) has any open returns that include DOTAS notifications or whether any ongoing disputes with HMRC include issues that may be the subject of follower notices. There are also potential cash flow issues. For instance, how any APN that is issued will be funded by the target company; whether any provision for a dispute that might be the subject of an APN needs to be reflected in any locked box arrangement; and whether any overpayment made under an APN will be taken in to account under the tax covenant. Specific due diligence will be needed for each transaction and care taken in relation to both the ultimate liability for any disputed tax and also the associated cash flow costs.

Similar disputes

The second area of change relates to disputes about issues that apply to more than one taxpayer. Often taxpayers and HMRC take a different

approach to tax disputes. Whilst taxpayers simply want to resolve their own disputes (and can generally do so only on a bilateral basis), HMRC takes account of what other taxpayers have been doing and may litigate where there is significant tax 'at risk' or there are issues that apply to several taxpayers (even if HMRC might be said to be unlikely to succeed on that particular case). This principled approach should come as no surprise to taxpayers – HMRC's position is set out in its Litigation and Settlement Strategy document and associated guidance. In any event, the information advantage HMRC have over taxpayers is a natural (and necessary) consequence of HMRC's duty to treat taxpayers equally.

To balance this, the mechanics for dealing with 'similar' disputes were primarily in Rules 5 and 18 of the Tax Tribunal Rules (and, broadly, allowed the Tribunal, at its discretion and/or following an application by one or more parties, to order that a particular case be a 'lead' case and other cases be bound in respect of the same issues of fact or law). These rules are not difficulty-free – the public list of Rule 18 directions was not always reliable and we've seen both heavily contested applications as to whether particular cases should be bound under Rule 18 as well as successful applications by taxpayers to unwind orders made under Rule 18. They did (and do), however, provide an independent regime for both HMRC and taxpayers.

By contrast, the new rules are more one-sided, perhaps understandably so given the political and legislative focus on tackling tax avoidance. For instance, the follower notice regime in FA 2014 allows HMRC to tell one taxpayer to settle their dispute in line with a final judicial decision in another taxpayer's case which, in HMRC's view, is relevant to the issues in the first taxpayer's case. Though yet to be really tested, the follower notice regime could act as a powerful deterrent to taxpayers who want (but can't necessarily afford) to continue their dispute. The proposed issue-based closure notice rules will enable HMRC to take specific issues to Court (even if the rest of an enquiry is ongoing) and, if the Courts ultimately decide in HMRC's favour, there will be a non-appealable "Tribunal referral closure notice" plus a decision that can be used as the basis for future follower notices. A revised cost regime to protect both parties from frivolous claims or unreasonable behaviour would have been a more appropriate way to proceed.

It is only reasonable to expect HMRC to use the powers granted by Parliament. However, where does this leave taxpayers who believe they are fighting a 'similar' issue to others? For now, taxpayers should consider cooperating more closely with each other (perhaps through their advisers), take great care when faced with a possible Rule 5 or Rule 18 direction, pay careful attention to what is (and is not) covered by a particular closure notice (as the recent *Fidex* case reminds us (*[2014] UKUT 0454 (TCC)*) and be ready to communicate both internally and externally if forced to litigate critical or high-value issues. In the long term, and perhaps more optimistically, HMRC (or the Courts) may ensure these new wide powers are used in a targeted manner. In this context, it's worth remembering that taxpayers have had success recently before the Courts where the facts and law have been properly presented (for instance the BUPA consortium relief case, which was itself a 'lead' case (*[2014] UKUT 0262 (TCC)*). Of course, limited sympathy can be expected for the mass-marketed scenario envisaged in HMRC's original follower notice consultation where essentially identical schemes have been entered into by multiple taxpayers. However, in more nuanced cases, the extent to which any particular decision will ultimately be held to be a 'relevant decision' for the purposes of issuing follower notices to other taxpayers should be more thoroughly tested. For instance, decisions such as the recent Court of Appeal ruling in the Eclipse case (*[2015] EWCA Civ 95*) will be loudly cheered by HMRC, but whether that really means all film finance LLPs will be treated as not trading is less clear.

Moving the goal posts

The third important area where the landscape has changed significantly in recent years is in

relation to what is (and what is not) acceptable tax planning. The increasingly active and high-profile approach taken by the European Commission to open investigations into past tax rulings (and condone breaches of taxpayer confidentiality) demonstrate this change at the European level.

In the UK, particularly given the external pressures on HMRC, there have been several attempts to tackle the perceived 'bad guys' of the tax avoidance world. Hence the new rules (actual and proposed) for 'high risk promoters' (in Part 5 of FA 2014 and subsequent regulations) and 'serial' tax avoiders (in the recent consultation) on strengthening sanctions in tax avoidance. These measures may well be justified in a more targeted form but, in the current political climate, few are prepared to oppose them at all.

This leaves untested the risk of potential unintended consequences in the legislation, the retrospective nature of the new approach and the risk of mission creep after new powers are adopted. For instance, the rules on promoters may well cause real practical difficulties for in-house tax functions advising across a complex (or changing) corporate group (see box).

> In making regulations that are specifically designed to take intra-group tax advice out of the new "high risk promoter" rules, it is clear that the Government did not intend those rules to target in-house tax professionals advising related companies. However, it is hard to see how the regulations provide an adequate safe harbour for all but the simplest group arrangements. For instance, services provided to JV companies or former group members under a transitional service agreement are not covered by the regulations.

Likewise, DOTAS is now being used as a hallmark of bad behaviour and, particularly since a DOTAS notification can be a barrier to Government work under the public procurement rules, this may result in a more wary approach to making precautionary DOTAS notifications or discourage real-time communication with HMRC. While tax authorities around the world should be praised for being responsive to changing circumstances, too much moving of the goal posts or subsequent mission-creep undermines business confidence and can discourage investment.

Final thoughts

There have, of course, been positive developments. HMRC's work on developing alternative dispute resolution seems to have been broadly well-received - and we know from our Best Friend firms that this is something other tax authorities are considering too. The recent consultation on simplifying the penalties regime could also help bring clarity for taxpayers. For many taxpayers, however, the overall impression of the changes in the last two years is of too many new rules that shift the balance of power in tax disputes to HMRC. More than ever, therefore, taxpayers need to take care when dealing with contentious tax issues, whether as part of active disputes, an M&A transaction or day to day business. While there should be considerable sympathy for HMRC in the current political and media climate, greater focus on using the existing powers in a targeted fashion may help close the much-reported 'tax gap' and also reduce confrontation with and uncertainty for the law-abiding majority of taxpayers (even if they don't have receipts for everything).

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