Treasury Sub-Committee's inquiry
into the conduct of tax enquiries and resolution of tax disputes
Evidence from the Low Incomes Tax Reform Group (LITRG)

1 Executive summary

1.1 Our interest in submitting this written evidence is in the predicament of unrepresented taxpayers aggrieved by an HM Revenue & Customs (HMRC) decision and, apart from a few remarks in response to the question about HMRC's *Litigation and Settlement Strategy*, we confine our remarks to the aspect of dispute resolution which we come across most often in our work for unrepresented taxpayers: compliance and penalties.

- HMRC's Litigation and Settlement Strategy should take account of the unequal negotiating strength between the Department and an unrepresented taxpayer and should guide HMRC officers, when dealing with the unrepresented, to take considerable care not to exert undue pressure on the taxpayer to come to any agreement but to direct the taxpayer to sources of pro bono help and advice where appropriate.

- While appellate structures generally work well, one is sometimes surprised that a matter has had to be appealed in the first place, and to allow certain disputes to get as far as the Tribunal is – in the words of one judge – a waste of everyone's time. There is a very strong argument for further safeguards, particularly to also protect those unrepresented taxpayers who may not have the confidence to start the appellate process. Better training of decision makers by teams carrying out statutory reviews and Tribunal judges would, in our view, result in fewer appeals or applications for review, and much better quality decisions overall.

- We are hugely concerned about the position of unrepresented taxpayers aggrieved by decisions against which there is no right of appeal. While the Adjudicator has a good record of impartiality, her role constrains her from challenging HMRC's policies and procedures and the only way this can be done, by judicial review, is beyond the means of the vast majority of unrepresented individuals. There is a strong case for a cost-free,

accessible alternative to judicial review, perhaps operating at Upper Tribunal level, to review discretionary decisions on the papers.

2 About us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Does HMRC's litigation and settlement strategy provide a rational and sound framework for resolving tax disputes?

3.1 The UK is perhaps unusual in that most disputes are settled by agreement between HMRC and the taxpayer. As is stated in HMRC's Code of Governance for Resolving Tax Disputes:

"Most disputes can be resolved collaboratively and by agreement once the facts have been established and the points at issue discussed, including cases where there is a formal appeal against the view we have taken. Only a very small minority of disputes need to be resolved by legal action, either in a tribunal or a higher court."

3.2 The *Litigation and Settlement Strategy* (LSS) is intended to provide a framework for resolving tax disputes by agreement with the taxpayer or through litigation. The object is "securing the best practicable return for the Exchequer". "HMRC will seek, wherever possible, to handle disputes non-confrontationally and by working collaboratively with the customer. In the majority of cases, this is likely to be the most effective and efficient approach."[1]

3.3 A likely drawback of this 'collaborative working' from the point of view of an unrepresented appellant is the unequal negotiating strength between taxpayer and HMRC. Unless the taxpayer is well represented, HMRC can crush his or her case by sheer weight of the resources available to a large department of State. If a case gets as far as the tribunal, a sympathetic judge may well try to put an unrepresented taxpayer's case in the best light, or the President of the Tribunal

[1] HMRC's Litigation and Settlement Strategy (2017), para 9.

may seek a pro bono representative if there are several individuals appealing on a difficult or important matter of law (see, for example, *LH Bishop & Co Ltd and Others v C&E Commrs* [2013] UKFTT 522).

3.4 Nevertheless, unrepresented individuals may well feel intimidated by the whole process – the length, the likely cost, the strong-arm tactics sometimes used by HMRC lawyers, and by the unfamiliarity with proceedings in the Tribunal. What they arguably need is a simple process which guarantees them an answer within a set time-scale, protection from costs, sound guidance on whether they have a reasonable chance of winning, and – at the Tribunal – appropriate safeguards against the consequences if HMRC decide to appeal a first-instance decision in favour of the taxpayer. Mostly, those requisites are provided by the statutory review process (see para 4.2 below), yet it is still very common to find unrepresented appellants in the Tribunal.

3.5 HMRC's LSS would benefit from a paragraph that focused on how officers should conduct themselves in a dispute with an unrepresented taxpayer, in particular directing the taxpayer to sources of pro bono help and advice where appropriate and taking care not to exert pressure on the taxpayer to enter into any agreement but to give the taxpayer time and space to make informed decisions.

4 Does HMRC's approach to enforcing compliance with tax law, including its approach to penalties and other sanctions, result in disproportionate or unjust outcomes? If so, how can the situation be remedied?

4.1 The aspect of HMRC's enforcement activity which we find most affects unrepresented taxpayers is its approach to imposing penalties for non-compliance, particularly non-filing of returns. While appellate structures are in place and generally work well, there are times when one is surprised that a matter has had to be appealed in the first place.

4.2 Those appellate structures which come into play if HMRC and the taxpayer cannot agree on a penalty or compliance matter can either involve the Tribunal or an internal appeal mechanism within HMRC. In brief, the taxpayer has the option of asking that any appealable decision be reviewed by officers within HMRC who are removed, in terms of line management, from and at least one grade above the original decision maker. Otherwise they may appeal directly to the Tribunal, but even if they opt for internal (or statutory) review they may still lodge an appeal with the Tribunal against the decision of the review team. The optional nature of HMRC's statutory review compares favourably with the Department for Work and Pensions' (DWP) version, which is a compulsory step that every appellant must take before they can appeal to the Social Entitlement Chamber of the First-tier Tribunal.

4.3 The system of statutory review is popular with unrepresented taxpayers (82% of those who used it in in 2016/17 were unrepresented, 87% in 2015/16).[2] That is hardly surprising as there is no

[2] HMRC Annual Report and Accounts 2016-17 – Report of Tax Assurance Commissioner (pp 107ff).

cost to the taxpayer and the process is time-limited – a review must be concluded within 45 days unless the taxpayer agrees to extend the time.

4.4 Reviews may be requested of decisions on liability, closure notices and refused claims, but the majority of decisions sent for review concern the imposition of penalties, particularly automatic penalties for late filing and the VAT default surcharge. In 2016/17, 48% of decisions on all cases including VAT penalties were upheld on review, the rest being either varied (8%) or cancelled (44%), while only 35% of VAT penalty cases (including the default surcharge) were upheld. In 2015/16, equivalent figures were 43% of all cases upheld, 35% of VAT penalty cases. On one view, the high percentage of decisions cancelled or varied reflects well on the impartiality of the review teams, but badly on the quality of initial decision making. That may not be surprising in a system of penalties that is primarily automated. When challenged, HMRC have responded that often new information becomes available to the review teams that was not available to the original decision maker. Doubtless that is true, but we doubt whether it fully accounts for the comparatively low upheld rate.

4.5 Also, we have heard HMRC personnel express the view that the decisions subject to review are more likely to be incorrect because the taxpayer has asked for them to be reviewed; other decisions are more likely to be correct because no review has been requested. Equally, it could be argued that the decisions subject to review are the tip of an iceberg, representing the comparatively few taxpayers who have summoned up the courage to challenge an official decision – many unrepresented taxpayers would simply let the matter rest because they were not sure on what grounds they could make any objection, or were worried about being blacklisted. We are not aware of any data about what proportion of all HMRC decisions go to review; but the number of decisions reviewed in 2016/17 amounts to less than 30,000, which must be a small fraction of total reviewable decisions made by HMRC during the year.

4.6 HMRC's Annual Report and Accounts for 2016-17 states (p 107) that:

"The outcomes of reviews help identify changes and clarifications that may be needed in our guidance or practice notes. Our review teams also conduct lessons learned exercises. Where we identify errors or mistakes we feed back to the decision maker highlighting the points in question."

4.7 We do not doubt that assiduous efforts are made to learn from mistakes in initial decision-making. Why, then, has there been no discernible improvement in the quality of those decisions? The indifferent 'upheld rate' in 2016/17 forms part of a pattern which stretches back to when the statutory review system was first instituted in 2009, although the upheld rate for cases other than VAT penalty cases shows an improvement in 2016/17 (64% as against 55% for 2015/16).

4.8 Interestingly, appeals to the FTT tell a different story. HMRC are generally more successful in litigation, with an 84% success rate before the FTT in 2016/17, a slight improvement on the 82% success rate in 2015/16[3]. This is probably because the cases that go before the FTT are generally either those that have not been successful at the review stage, or those where HMRC and the

[3] HMRC Annual Report and Accounts 2016-17 – ibid

taxpayer have not been able to agree a settlement under TMA 1970 section 54.[4] Nevertheless, as we shall show (para 4.10), some cases reach the FTT that should never have been allowed to get so far.

4.9 In our view, at the root of many problems with HMRC's approach to penalties is the fact that many initial decisions – particularly those on the issue of penalties – are automated, which seems to preclude the exercise of judgment by individual officials unless and until the taxpayer challenges the decision. This is then compounded by occasional poor judgment when deciding on a response to a taxpayer who appeals or objects to a penalty, particularly where the grounds of appeal or objection are reasonable excuse or special circumstances.

4.10 For example:

- In the First-tier Tribunal (FTT) case of *Beardwood* [2018] UKFTT 0099 (TC), the taxpayer was penalised because he acted in reliance on incorrect official guidance, and because HMRC refused to accept his appeal on grounds of reasonable excuse the matter ended up in the FTT, doubtless at disproportionate and unnecessary cost to the Exchequer. The Tribunal observed that this was a case which should never have come before it. "The tribunal considers that HMRC have wasted everyone's time in bringing a case which has very little merit on their side and where the taxpayer seems to have acted in an exemplary manner. Nothing would have been gained by the issue and completion of the return, no tax was at stake, and another HMRC department had already realised that the appellant's wife, who was in very similar circumstances, should not be penalised."

- In another FTT case, *Goldsmith* [2018] UKFTT 5, the judge found for the taxpayer on other grounds, but observed also that HMRC did not apply the tests set out in their own guidance when considering whether the late filing penalties were eligible for 'special reduction'.[5] If the tests had been applied correctly, it would have resulted in reducing the late filing penalties to nil rather than pursuing payment in full as far as the FTT.

4.11 While the system of statutory review seems robust, and the Tribunal itself fair, there is a strong argument for further safeguards, particularly to protect unrepresented taxpayers who may not have the confidence to start the appellate process. We would recommend that if those making decisions at first instance were to receive more comprehensive, generic training from review teams, for instance about common reasons why first instance decisions are overturned, and that training were supplemented by members of the judiciary passing on lessons from Tribunal cases (particularly those involving reasonable excuse or special reduction), then initial decision makers would make better decisions. This might in time reduce the numbers of review requests or

[4] Under TMA 1970, section 54, after an appeal is lodged but before the matter comes before the Tribunal, HMRC and the taxpayer may come to an agreement about whether the decision appealed against should be upheld without variation, or varied, or cancelled. The agreement then has effect as though the Tribunal had made an order in those terms.

[5] FA 2009, Sch 55, para 16: "If HMRC think it right because of special circumstances, they may reduce a penalty. . ." According to HMRC guidance (CH170600), 'special circumstances' are either uncommon or exceptional, or where to apply the law strictly would be contrary to the clear compliance intention of the penalty legislation.

appeals to the Tribunal, and result in better quality decisions in cases which are not appealed or sent for review.

4.12 ***Decisions that do not carry a right of appeal***

4.12.1 HMRC decisions that involve the exercise of discretion often do not carry a right of appeal. Such decisions might involve the application of extra-statutory concession A19, under which HMRC has a discretion to write off tax arrears that have arisen through HMRC's failure to make proper use of information in its possession and the taxpayer could reasonably believe that his or her affairs were in order, or the substitution of a 'just and reasonable' recalculation of the tax on a chargeable event gain on a part surrender that was 'wholly disproportionate' to the economic gain.[6] In such cases, the taxpayer can try lodging a complaint which might get as far as the Adjudicator, and the Adjudicator has a good record in handling cases such as refusal of A19. But given that the Adjudicator cannot step outside the constraints imposed on her by HMRC policy and procedures (her role is rather to ensure that HMRC abides by their own processes, than to tell HMRC what those processes ought to be), there are cases where the only real remedy is by way of judicial review, which, because of its upfront costs and risk of an adverse costs order if unsuccessful, is way beyond the means of the vast majority of unrepresented taxpayers. Besides, the criteria for a successful judicial review application – that the decision appealed against was wholly unreasonable or the authority making it had misdirected itself – set a very high bar.

4.12.2 It would help unrepresented taxpayers if they had a means of appealing against decisions involving the exercise of discretion that may be outside the remit of the Adjudicator without having to incur the high cost of a judicial review application. What is needed is a cost-free and accessible panel at, say Upper Tribunal level that can review discretionary decisions on the papers, to determine whether the decision-maker took into account and gave due weight to all relevant factors, eschewed irrelevant factors, and acted within the parameters of the official discretion allowed to him or her. Such a panel could be set up at relatively low cost and would fill a gap in the appellate structure currently available to unrepresented taxpayers.

LITRG

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[6] ITTOIA 2005, section 507A.