TaxZone Newthwire

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(1) Introduction

Tax Investigations and Enquiries have been the subject of regular queries on Any Answers, and remain one of the major preoccupations of small practitioners. This subject has been covered, to one extent or another, in the following previous Newthwires:

Issue no. 2 - Enquiries and Investigations –27 May 2002
Issue no. 32 – Interest & Penalties, Part 1 – 4 August 2003
Issue no. 34 – Interest & Penalties, Part 2 – 1 September 2003
Issue no. 49 – Fraud, Searches and Prosecutions – 13 April 2004
Issue no. 61 – Tax Geared and Capped Penalties, Part 1 – 27 September 2004
Issue no. 62 – Tax Geared and Capped Penalties, Part 2 – 11 October 2004
Issue no. 72 – Self Assessment Enquiries – 21 March 2005

(2) Merger of the Departments

Since I first wrote on this subject, we have seen the merger of the Inland Revenue and Customs & Excise into one department – HM Revenue & Customs.

If there is one area of taxation that will be affected by this merger, it must be tax investigations and enquiries. Traditionally, VAT Inspectors have adopted a much more aggressive approach to investigations, using, in some instances, powers exceeding those of the police. Will the procedures of what was Customs & Excise be adopted for direct tax purposes within HMRC? Or will the more statutory and well-researched practices of what was the Inland Revenue soften the previously more aggressive approach of VAT inspectors?

Time will tell, but it has been announced that, as from 1 September 2005, tax investigations and enquiries will be conducted jointly by direct tax inspectors and VAT inspectors. This fact needs to be taken on board by all practitioners.

Two obvious implications are apparent. First, if an investigation meeting takes place, it is likely that representatives from each branch of the department will be present. It is imperative that the accountant finds out before the meeting who will be present from HMRC.

Second, it has been the practice of what were VAT inspectors to call on registered businesses without appointment, and in an obvious attempt to question the registered trader without the accountant being aware of the visit or being present. Clients must be forewarned of this possibility. Except where a 'raid' under section 20C, TMA 1970 is in progress, there is nothing wrong with the trader stating politely that it is not convenient to hold a meeting at that time, and could the inspector(s) arrange another appointment.

Planning Point

Accountants must take on board that investigations and enquiries are now likely to be carried out jointly by direct tax inspectors and VAT inspectors. They should make sure that they know the names and functions of those to be present at any meeting. Clients should also be briefed to ensure that they are not pressured into any unannounced meeting with visiting VAT or other direct tax inspectors.

(3) HMRC Reorganisation

Although HMRC reorganisation is likely to be of more interest to larger firms of accountants, it is worth mentioning what has occurred. Except for the Anti-Avoidance Group, which is part of Corporate Functions, national and local compliance are part of the Operations Division of HMRC.

Operations and Tax Law Enforcement cover detection, intelligence (including NCIS liaison) and exchanges of information. This also incorporates Special Civil Investigations (replacing SCO), which deals with Code of Practice COP 8 investigations and investigations under the New COP 9. Investigations under this heading include complex avoidance, marketed schemes and Special Projects. The Large Business Service also comes under Operations.

Also under the same department are Criminal Investigations, which deal with the shadow economy, money laundering and liaison with the serious organised Crime Agency (SOCA) and the Revenue and Customs Prosecutions Office (RCPO).

Within SCI is the Offshore Fraud Project Group. Within the Anti-Avoidance Group is AAG (Intelligence), AAG (Policy), AAG (Investigations) and JITSIC (Joint International Tax Shelter Information Centre).

Revenue & Customs Prosecution Office is a separate office with a director appointed by the Attorney General. Its functions are to carry on prosecutions initiated by HMRC, to initiate prosecutions arising out of criminal investigations by HMRC, and to provide legal advice relating to criminal investigations or criminal proceedings. The Attorney General may assign to RCPO cases to advise upon or prosecute. RCPO prosecutors must follow the Code for Crown Prosecutions in deciding whether to prosecute. However, there appears to be a potential conflict as RCPO is not the exclusive prosecuting authority in relation to tax offences, and HMRC retains the power to institute its own proceedings.

Following the Serious Organised Crime & Police Act 2005, a new agency will become operational on 6 April 2006. This is the Serious Crime Agency (SOCA). SOCA brings together the National Crime Squad, NCIS and the investigative and intelligence work of HMRC relating to drugs and smuggling. SOCA is not just about criminals, and one of its functions is interchange of information with HMRC. There is no proportionality regarding the information that it discloses.

Much of the above may seem academic to most of us, but it illustrates that HMRC and the Government are getting highly organised, and are serious about anti-avoidance, tax fraud and the shadow economy. A recent tax case has underlined that financial institutions may be compelled to reveal details of interest received by customers on offshore accounts, so that these developments should be taken very seriously. Combined with the work of the existing Assets Recovery Agency, they represent a very heavy and organised armoury in the hands of government and HMRC.

Planning point

Practitioners should take note of the new HMRC organisation and the new RCPO and SOCA agencies. Any clients who fail to declare interest on offshore bank accounts are now likely to be exposed sooner or later.

(4) COP 9 and Hansard

Practitioners have become used to the various versions of 'Hansard' over the years. Basically, this related to a Parliamentary Statement to the effect that, if a taxpayer under investigation was offered Hansard and co-operated during the investigation and 'came clean', then no criminal prosecution was likely to follow.

Well, Hansard is now 'dead'. Following the cases of *R v W* [1998] STC 550, *R v Gill* [2003] BTC 404 and human rights legislation, Hansard was abolished by the publication of the revised Code of Practice COP 9, effective from 1 September 2005.

In tax investigations involving serious fraud, and where investigators from Special Civil Investigations (SCI) deem it appropriate, cases will be conducted under Civil Investigation of Fraud procedure (CIFP). Meetings will no longer be conducted under PACE 1984 (which in many respects has been replaced by SOCPA 2005) and tape recorders used previously will now be 'mothballed'.

Where SCI decide to adopt CIFP in any given case, they will not seek to prosecute the fraud that was the subject of the investigation. This is subject to the proviso that prosecution may still be considered if there is a materially false disclosure during the investigation, which could be the furnishing of a document known to be incorrect during or at the end of the investigation. It should also be noted that the level of penalties will be significantly higher in the case of non-co-operation.

The CIFP procedure will only be used by SCI investigators, and much of the previous COP 9 procedure remains the same.

The future of Code of Practice COP 8 cases is more uncertain. It seems that future cases will be devoted to schemes (perhaps marketed) and projects. 'Stand alone' cases may be dealt with by Complex Personal Return (CPR) teams.

Planning point

Accountants should be aware of the demise of Hansard and the issue of revised Code of Practice COP 9.

(5) Money Laundering

Another piece of legislation that has revolutionised tax investigations is money laundering. The Money Laundering Regulations 2003 and Proceeds of Crime Act 2002 affect every professional firm, and accountants to a great degree.

I do not propose to consider this subject in detail, but it impinges on every case where the accountant knows or has suspicion that the client may have committed a money laundering offence. In such case, the appropriate report has to be made to NCIS before any work can commence on the tax investigation. Expert advice is available on this site regarding this subject from David Winch.

Where a client undergoes a self-assessment random or full enquiry, the issue of money laundering is less likely to arise, as no money laundering offence may have been committed, and any 'innocent' defaults may well have not come within the money laundering sphere. However, it remains a large extra administrative burden for practising accountants, who, *inter alia*, will have to appoint a Money Laundering Reporting Officer.

Planning point

Accountants need to be *au fait* with the practical effects of the money laundering law and regulations. A Money laundering Officer must be appointed. Small firms may need to appoint an outside money laundering consultant.

(6) Current investigation issues

Most of us have as our main investigation concern self assessment enquiries, whether they be random or not, and whether they are 'aspect' of 'full' enquiries.

Certain issues keep re-occurring as problems, and it is worth highlighting some of them as follows:

- Private bank accounts

Many clients have received requests for private bank records routinely as part of the opening letter of a self-assessment enquiry. This matter is dealt with in HMRC Enquiry Manual, and the consensus of opinion seems to be that such records need only be produced if they have some bearing on the accounts, assuming this is an enquiry into the business records.

One does not want to antagonise the inspector, but a polite question as to the reason for the request is not out of order. The practitioner should ensure that the terms of the HMRC Enquiry Manual at EM 2220 and 2221 are adhered to.

In the case of a company enquiry it is quite out of order for the inspector to make a request for any private records at all, unless he has instituted a section 9A enquiry into the affairs of the director concerned.

Planning point

Unless there is a direct link with the business accounts, it is not unreasonable to query a request from HMRC for the production of private bank statements and other private records. Practitioners should ensure that HMRC staff comply with their own manual.

- Meetings

The inspector will always demand a meeting, usually at the outset of an enquiry. He has no legal right to force the taxpayer to attend, but a complete rebuff might be regarded as lack of co-operation.

One solution is for the accountant to ask that he and the inspector have an initial meeting where the accountant is able to provide general details of the business and records. It may be that the remainder of the enquiry can be dealt with by correspondence.

If it is necessary for the client to attend a subsequent meeting, three issues are vitally important. The first is the venue. The HMRC offices are too intimidating. The client's business premises are not a wise choice, although the client may feel more at home there. One does not want the inspector 'snooping around'. The best neutral choice is the office of the accountant.

Second, it is important to ascertain who will be representing HMRC at any proposed meeting. How many tax officers will be present? Are they all form the same TDO? What are their roles within that office? Is a representative of HMRC Accountants Department, the VAT department or the District Compliance Inspector likely to be present?

The other issue is the agenda for the meeting. One has to recognise that the inspector is well trained in meetings procedure, and will use his or her training to intimidate the client. HMRC do not like this, but a request for a detailed agenda is not unreasonable.

If the inspector defers, there is no harm in the client saying 'I will have to look that point up and let you know later' if unscripted questions are asked. Although one should not coach the client beforehand, he or she should be warned that 'off the cuff' answers or observations at the meeting could be extremely dangerous.

The other issue about meetings concerns the request by the inspector for the client to sign a record of the meeting. This should never be agreed to. The accountant (or an accompanying secretary) should make notes as the meeting progresses and subsequently compare his notes with those of the inspector, pointing out any variances. This is obviously time consuming, but much damage can be done if this aspect is not handled properly.

Finally the inspector may ask for a final meeting, known as a 'settlement' meeting where the level of penalties is agreed. This meeting is not really necessary these days, but if the accountant agrees to it, he or she alone should be present, not the client.

Meetings need to be taken seriously by the accountant. Prior preparation, liaison with the client and assessment of the sequel of any meeting are necessary.

Planning points

Accountants need to take investigation meetings very seriously. Prior preparation and post analysis at the sequel of the meeting are very important. It should be ascertained beforehand which HMRC personnel will be present. The venue of any meeting is important. A prior agenda should be agreed wherever possible. Post meeting notes prepared by HMRC should never be signed. The practitioner or a member of his staff should make their own notes.

- Working papers

The accountant's working papers are his or her own property and should never be handed over in total to the HMRC, except where a legal direction has been made under section 20, TMA 1970. The terms of HMRC Statement of Practice SP5/90 apply.

Having said that, there are many cases where the books of the client are incomplete to one extent or another. In such cases it is sensible to provide the inspector with copies of cash & bank reconciliations, journal entries and the extended trial balance, so that the inspector can understand the books of account in relation to the accounts already submitted.

It is better to either rewrite pages of the working papers, or photocopy part of pages, where a page contains other information that does not concern the investigation and/or year of enquiry.

Planning point

Accountants should take care when HMRC request working papers or any extract from them. The working papers should never be produced in entirety, but copies of parts may be supplied in order to enable the inspector to reconcile the books of account with the submitted accounts.

- Failure to close

Practitioners report that, in some instances, inspectors prolong an investigation or enquiry unnecessarily, particularly where they have failed to 'break the records'. In such cases and where it is in the client's interests, the practitioner should consider early application to the Appeal Commissioners for the investigation to be closed under the provisions of section 28A, TMA 1970. This facility should not be used routinely in all cases.

Planning point

The facility to apply to the Appeal Commissioners for closure of an Enquiry under section 28A, TMA 1970 should be used where necessary, but not routinely in all cases.

- Mandates

SCI inspectors have always used bank and other mandates in order to obtain information about the taxpayer under enquiry. It is understood that this practice has been adopted in some local office enquiries. It should be recognised that a mandate enables the inspector to obtain more information than even under a section 20 notice. The greatest care should be taken in advising clients to sign such mandates, particularly where they are 'open-ended'. It is probably better for the accountant to obtain copies of information, when required.

Planning point

The practice of HMRC staff asking taxpayers to sign bank and other mandates appears to have spread to local enquiries. Extreme caution should be exercised in allowing a client to sign such a mandate.

- Production of Documents

In the opening letter of a self-assessment enquiry the inspector will ask for the production of books, accounts and other documents in connection with the business period under enquiry.

Notice that the taxpayer is required to *produce* the items required – not send them to the tax office. Some commentators suggest that they should be produced at the office of the accountant, and then photocopies made of the items that the inspector wants to take away.

There is no doubt that, if the inspector retains all the books of a business at his office for several months, this can cause substantial disruption to any business, quite apart from the legal position.

Planning point

Where the books of a business are requested to be produced in a self-assessment enquiry, find out from the client whether the absence of the books will produce any significant disruption to the business. If so, try and agree some compromise method of complying with the law, such as producing books, accounts and documents at your office.

- Section 19A notices

In a self-assessment enquiry, the inspector may issue a notice under section 19A, TMA 1970 at the time of initiating the enquiry, or very soon afterwards. This notice applies to information in the specific tax return under enquiry, it must be 'reasonably required' and the information must be in the possession or power of the taxpayer.

It should be recognised that a section 19A notice can be appealed to the Commissioners. The notice is suspended until the appeal has been heard, but the Commissioners' decision on the notice is final.

Some commentators suggest that the appeal process is used too rarely by accountants, and the (perhaps premature) issue of section 19A notices should often be challenged. The issue is whether such a notice should be issued so early in an Enquiry, and whether it is 'reasonably required'.

Planning point

Accountants should be aware that a section 19A notice issued to a client can be appealed, and should undertake such an appeal where the notice has been issued unfairly or prematurely.

(7) IDEA

IDEA is a new piece of software that has been made available to inspectors of taxes. It is understood that this is a piece of data investigation software that searches records for key words such as ''entertaining', 'advertising' and 'hospitality'.

IDEA is the main tool of HMRC for examining computer records.

(8) Enabling letters

'Enabling Letters' from HMRC have been around for a few years now. Initially they related to very small accounts only. In 2004-2005 they were extended to businesses with larger turnovers. Another addition has been enabling letters sent to taxpayers who receive income from offshore.

In a way these letters are a possible warning of a future investigation or enquiry. Unfortunately many taxpayers regard them as intimidation, and will blame the accountant for their issue.

It is suggested that all clients are reassured that the issue of enabling letters is part of the administration of HMRC, but nevertheless any such letters should be sent on to the accountant.

Planning point

Clients should be reassured about Enabling Letters, but nevertheless asked to forward them to their accountant.

(9) Settlement

Most investigations and enquiries end with a contract settlement containing tax, interest and penalties. It will be one of final jobs of the professional adviser to negotiate with the inspector about the level of penalties.

Starting with a figure of 100%, percentage mitigation is given for disclosure, co-operation and seriousness (which is divided into size and gravity). This subject has been covered in earlier Newthwires in detail.

However, where the inspector suggests a total percentage penalty, he or she should be asked to divide the mitigation into the various components. It is just possible that this request could lead to further mitigation.

Planning point

Where HMRC suggest a total mitigation of a tax penalty in an investigation, they should be asked to divide the mitigation into the various components. This may just be the basis for further mitigation.

(10) Professional Expenses Insurance

The accountant's costs of dealing with a tax investigation are heavy, and even in the smallest cases are likely to be more than £thousand. As far as the client is concerned, this adds insult to injury, and sometimes the fee has to be written off or reduced, or is paid very late. A sensible solution for all concerned is professional expenses insurance, and this will be the subject of a forthcoming Newthwire.

Planning point

Professional expenses insurance ensures that the reasonable professional costs of dealing with a tax investigation will be recovered.

(11) Conclusion – Prevention

A tax investigation or Enquiry is an extremely stressful event for the taxpayer, and perhaps also the accountant, and inevitably disrupts the business. There is no means of preventing a random enquiry under the self-assessment legislation or the actions of a taxpayer who deliberately falsifies books or extracts cash from the business (both of which are tax frauds), but accountants may be able to stress to clients certain steps that they can take to minimise other types of investigation. Some of these that affect both parties are;

Taking into account the 'Ten Top Tips to get your Return right' that HMRC issued on 10 January 2006.

Observing time limits for the filing of returns and paying tax due.

Making sure that new sources of income are declared within the appropriate time limit.

Making sure that unusual items are explained in the 'White Space' of the annual tax return. This is mainly the responsibility of the accountant once he or she knows the details. This includes unusually low drawings, variances in gross profit %s and unexplained introduction of capital. Also high business expenses for the type of trade and large variances annually in the level of income and expenses.

Educating clients to keep good records, so that they do not offend against section 12B, TMA 1970.

Ensuring that clients tell you the whole truth about their business and personal affairs.

Ensuring that there is good communication between you and your client.

Getting to know the client well. Are their savings growing inexplicably? Is their lifestyle consistent with their tax returns?

In the case of larger businesses, are internal controls adequate?

Some of this is 'pie in the sky', but prevention is far better than cure, particularly with tax investigations.

Planning point

Stress to clients that prevention is better than cure, and acquaint them with a list of obligations that may prevent any investigation, other than a random one.

Ask a question

Readers with a current case should post their query in Any Answers.

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http://www.accountingweb.co.uk/premium_content/newthwire

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