ACTIVE PRACTICE UPDATES

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CRANE & JOHNSTON

CHARTERED CERTIFIED ACCOUNTANTS
REGISTERED AUDITORS

HMRC investigations

What to expect when the Revenue comes knocking.

Anyone whose business comes under the Revenue's microscope is usually in for a roller-coaster ride.

HMRC has upped its game in recent years when it comes to probing businesses or sole traders who may be suspected of falsely reporting or underpaying tax.

Nobody appears to be beyond its remit, whether you're the chief executive of a Premier League football club or the owner of a microbusiness with a much more modest turnover.

Despite its reputation, HMRC's first approach is to negotiate to bring in as much of the money it is owed as possible as cost-effectively as possible – and that usually means pursuing settlements over prosecutions.

There are various ways to keep you or your business off HMRC's radar, with the most basic method being maintaining accurate records for us to process.

Triggers

If a small business suddenly makes a large VAT claim or a big firm declares an unusually low amount of tax, it's likely to set alarm bells ringing at HMRC headquarters – and it doesn't stop there.

Businesses may become the target of an investigation if:

- HMRC receives a tip-off
- your business routinely takes cash payments
- you consistently file late tax returns with major inconsistencies
- your business operates in a sector HMRC has specifically targeted
- it is randomly selected by HMRC for investigation.

Taxes

The biggest misconception is that HMRC purely investigates matters relating to income tax. It doesn't – HMRC probes all kinds of other tax including, and not limited to:

- capital gains tax
- corporation tax
- landfill tax
- national insurance contributions
- VAT.

Stages

There are three levels of HMRC inquiry:

Random

Just to keep businesses of all sizes on their toes, HMRC has the ability to select and investigate your enterprise entirely at random. There's usually no rhyme or reason to this.

Aspect

HMRC is worried about a particular part (or parts) of your accounts and wants more detail.

These are usually straightforward mistakes or misunderstandings rather than deliberate attempts at tax evasion, such as forgetting to include all your savings income on your self-assessment tax return.

These types of inquiry may appear less stressful than full investigations, but they should still be treated seriously.

If HMRC uncovers anything else during its inquiry, they may upscale it to a full inquiry.

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HMRC investigations

Full

A full inquiry looks at cases where HMRC believes there is significant risk of error in the tax return.

If you're subject to a full inquiry, you can expect the Revenue to undertake a comprehensive review of your records.

For businesses, this may include scrutinising the personal financial records of directors or the business owner as well as all business-related records.

The process

First contact

HMRC will initiate contact with you, usually by letter or phone, with a query over your accounts.

If you receive a brown letter through the post, don't panic. It's perfectly acceptable to ask them to contact us at this stage as we're happy to liaise with HMRC on your behalf.

We will find out the severity of the inquiry (full, aspect or random) and the information HMRC requires to resolve its investigation.

Information

What details HMRC requires will depend on the severity of the inquiry, but you will be expected to supply the information which formed the basis of the tax return being scrutinised.

If there is any information missing in your tax return, you may be required to track down replacement copies to back up your claim.

This should also be the stage of the investigation to hold your hands up and inform HMRC if you have knowingly made a mistake. Owning up now will stand you in good stead further down the line.

Investigation

The Revenue will formally commence its investigation once it has all the records it needs. In many cases where minor discrepancies are involved, these can be resolved fairly quickly.

For example, you're a sole trader with no income protection policy who required two months out with a broken leg after falling from a ladder.

Your annual income for the financial year in question declined by a sixth as a result, but HMRC will be unaware of this until you inform them.

HMRC may request further information when more complicated investigations are under way.

In such cases, HMRC may ask to meet you at your business or accountant's office. You can ask us or your legal adviser to attend and request a pre-agreed agenda.

Outcomes

What happens next depends on what HMRC finds. Some of the more common resolutions include:

Underpaid tax

If the investigation finds you are short on your tax bill, you will have 30 days to settle it with HMRC.

Failure to do so will result in you incurring a penalty, which is calculated as follows:

- lack of reasonable care: a penalty of up to 30% of the extra tax due
- deliberate errors: a penalty of between 20% and 70% of the extra tax due
- deliberate and concealed errors: a penalty of between 30% and 100% of the extra tax due.

Overpaid tax

You may receive a tax rebate through the post in the event you have paid too much tax.

If you don't, and you have overpaid tax, you will need to make a claim with HMRC for a tax repayment.

Deliberate wrongdoing

In the most serious cases where HMRC believes you have committed fraud, you may be subjected to criminal proceedings.

You may also have to pay a penalty depending on:

- why you underpaid tax
- if you told HMRC about any mistakes as soon as possible
- if you were fully cooperative during the inquiry.

Resolution

HMRC will formally conclude its investigation by a decision notice or agreeing a contract settlement.

A **decision notice** arrives in the form of a letter, which outlines HMRC's assessment plus any penalty notices and its final stance.

A **contract settlement** legally binds you to pay the money owed to HMRC, which agrees not to use its powers to chase you for the settlement.

Avoidance tips

No business owner can do anything to prevent a random investigation, but there are other ways to ensure you remain off HMRC's radar.

- keeping good records will go a long way to ensuring you are compliant
- find out when your tax bills are due, put money aside to cover the costs and pay on time
- ask us if you are unsure about any aspect of your finances at any point during the year
- ensure your tax returns are filed accurately (we can handle this on your behalf)
- explain any changes or unusual activity from one tax year to the next.

Get in touch if you are under HMRC investigation.