Coping with HMRC enquiries: some practical guidance

Management of taxes | General Features



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Some useful guidance on how to handle a tax enquiry and best practice to ensure that you minimise the risks.

Key Points

What is the issue?

There are two main types of investigations: enquiries, where HMRC has a 12-month window to open an enquiry, and investigations, which cover tax years preceding the enquiry window and where HMRC suspects a loss of tax. The article focuses on proceedings under the Taxes Management Act 1970 and Finance Act 1998.

What does it mean for me?

Advisers should ensure that information requests from HMRC are reasonable, relevant and for the period under review. Providing unnecessary information can lead to additional costs and disputes. If unsure about HMRC's authority, advisers should ask for clarification.

What can I take away?

There are a number of key points to consider when responding to an enquiry, including the relevant period, formal enquiry status, information schedule, deadlines, requests for extensions, statutory records and non-statutory records.

If an error or omission leading to a loss of tax is uncovered, a voluntary disclosure should be made to HMRC as soon as possible. The reasons for the error and the affected periods should be considered, as they impact the potential lost tax, time limits and penalties.

Dealing with an HMRC enquiry can be a daunting task for a client, normally due to the uncertainty as to what the outcome will be and how long it will take. Irrespective of whether HMRC finds anything wrong, it is disruptive for the client. They may lose their focus on their business or work, and become frustrated with the speed at which progress is made or the approach taken by HMRC. The other main consideration is the financial cost of dealing with the enquiry, which can be significant.

Advisers also have the dilemma as to what they should do about their time costs in dealing with the enquiry. It is important to remember that the adviser can add real value to the process. The client will look to the adviser to provide support and guide them through the enquiry process so the costs, while possibly unwelcome, can add value by minimising the client's exposure.

Types of investigation

There are some basic steps that an adviser can take to prepare the client and to minimise the risks, with the aim of resolving the enquiry efficiently and effectively.

It is essential that on receipt of the opening letter the adviser checks which power HMRC is relying on. There are two basic types of investigation:

- **Enquiries:** The Taxes Management Act 1970 and Finance Act 1998 provide HMRC with a 12 month window in which to open an enquiry. It is vitally important that HMRC does this within this time limit, otherwise the enquiry is normally invalid.
- **Investigations:** Investigations normally cover tax years that precede the enquiry window and HMRC has reason to suspect that there may have been a loss of tax. There are time limits, but these depend on the type of behaviour that led to the loss of tax.

This article focuses on the main considerations where your client faces either a tax enquiry under the Taxes Management Act 1970 s 9A (individuals), s 12AC (partnerships) and Finance Act 1998 Sch 18 para 24 (companies).

Sharing information with HMRC

Whatever the type of enquiry, the approach is broadly the same. There are some key issues to consider and be mindful of when reviewing an enquiry letter from HMRC.

One simple check that advisers should make when responding to an opening letter or subsequent information request is to consider whether the request is reasonable and relevant and for the period under review. While it is important to cooperate fully with HMRC, the adviser should be wary of supplying information that HMRC does not have the right to ask for. A good example of this would be to provide bank statements that cover a period prior to or after that covered by the return. Once you provide the information to HMRC, the officer will critically analyse the information to determine whether there may be a risk that there has been a loss of tax.

Advisers may correctly assert that if there has been a loss of tax, there is no issue in providing the information. However, the situation can be more complex than this where the provision of the information leads to a disputed tax liability and significant additional professional costs are incurred to resolve the situation. By ensuring that only information reasonably required is provided, these costs could be avoided. It is always sensible to look at this issue objectively and where it is unclear as to whether the information is reasonably required that advice or guidance is sought.

If the adviser is unsure as to what power HMRC is relying on, ask the officer to confirm the position. Taking these simple steps can avoid problems in the future for both the client and the adviser. Unfortunately, disputed tax liabilities are often discovered by HMRC asking for information it was not entitled to. HMRC will ask for whatever information it considers is needed to check if there has been a loss of tax. It is the role of the adviser to check whether HMRC is entitled to ask for the information.

Key points to consider

1. **Correct address and person:** For an enquiry letter to be valid, the issuing officer needs to ensure that the enquiry letter is addressed to the right individual or entity at the correct or last known address.
2. **Relevant period:** It is important to verify the period that the enquiry covers and if HMRC is still in time to enquire into the period. Generally, this is 12 months from the date of submission for individual Self-Assessment tax returns, but it can extend to up to 15 months depending on the submission date and quarter end dates. For company corporation tax returns, it is 12 months from the end of the due filing date.
3. **Formal enquiry:** Determine if it is a formal enquiry under the Taxes and Management Act 1970 ss 9A or 12AC for individuals/partners or Finance Act 1998 Sch 18 para 24 for companies.
4. **Information schedule**: HMRC normally includes an information schedule with the opening letter, which lists the information that the officer considers is required to check whether the return was complete and correct. Always ask yourself whether the information is reasonably required to check the accuracy of the return and relevant to the period under enquiry.
5. **Information deadlines**: Note the deadlines for providing the requested information. Normally, HMRC provides 30 days to respond to an information request or enquiry letter.
6. **Requests for further time to respond**: While it may be necessary to ask for an extension to provide the relevant information, it is important to remember that HMRC will often grant a further 30 days but issue a formal information notice under Finance Act 2008 Sch 36. This can lead to a penalty for not complying with the notice and impact any reduction in the penalty where HMRC establishes that tax is owed. It is good practice for the adviser to project

manage the supply of information to minimise the risk of penalties.

7. **Statutory records**: HMRC is entitled to ask for the statutory records of a business and there is no right of appeal against this request.
8. **Non-statutory records**: It is not uncommon for HMRC to ask for information which may not be relevant to the tax return, such as a director's personal bank statements in a company enquiry or for the overseas bank statements of an individual who is non domiciled and subject to tax on the remittance basis. While there may be a valid reason for the request, it is incumbent on the adviser to consider the risks associated with providing information that may lead to a new line of enquiry or unduly prolong the enquiry.

Once you have considered whether the enquiry notice is valid, the adviser should take the following action:

- Gather all the relevant documents and details requested by HMRC. Check to make sure that the information is reasonably required to check the return and that it is for the relevant period.
- Review the information to understand the context and implications of the information requested. If there is anything that may need to be disclosed to HMRC, it is important that the adviser discusses this with their client straightaway and that a disclosure, where applicable, is made as early as possible. The main reason for this is that HMRC will review the timing of any disclosure when considering the penalty position.
- Respond to HMRC with the necessary information and any explanations or clarifications within the time limit provided by HMRC. If further time is required, it is important to request this before the deadline expires.

Voluntary disclosures

In dealing with the enquiry notice, the adviser may uncover an error or omission from the return, which has led to a loss of tax. It is important that a disclosure is made to HMRC as soon as possible and that the implications are fully considered. HMRC will critically analyse any disclosure to consider whether it may have an impact on earlier or later returns and the reasons for the error or omission. The reasons for this are twofold; to determine the potential lost tax and whether HMRC is in time to recover the tax.

It is best practice to consider what happened, which years or periods are affected and how this happened. (Was it a genuine error, a failure to take reasonable care or, in some cases, deliberate?) The reason for the loss of tax will not only affect whether HMRC is able to recover tax for earlier periods but also whether there is a tax-geared penalty. The normal time limit to recover tax is no more than four years after the period to which it relates; where there was a failure to take reasonable care the time limit is extended to six years; and for more serious matters the time limit is 20 years.

When considering whether a penalty is applicable, HMRC will wish to establish the behaviour that led to the loss of tax and to what extent the penalty should be reduced, which is based on telling, helping and giving – in other words, the level of cooperation provided, the timing of any acceptance or disclosure of a liability and the provision of the relevant information.

By considering these points, the client and adviser can potentially reduce the penalty by half, so it is essential that proactive steps are taken as this can have a significant impact on any liability.

How to resolve a dispute

There are inevitably situations where HMRC and the taxpayer may not agree on a liability. While HMRC offers alternative dispute resolution to resolve a disputed tax liability, the adviser can take proactive steps throughout the enquiry to minimise the risks. Being responsive, cooperative and constructive will almost always have a positive effect on the enquiry.

It is sensible to consider whether a meeting would be useful, as it sometimes difficult to convey all the facts in a letter. Written communications, while very important, do take time and money to deal with. While HMRC may not be able to travel to the adviser’s office to meet in person, a virtual meeting can also be very beneficial. It is essential that the discussions are constructive and that every effort is made to listen and better understand the position. What are the obstacles to resolving the dispute and how can these be resolved?

It is very rare for HMRC to conduct an enquiry on a random basis into a tax return, so it is safe to assume that the compliance team has already identified a risk that

there has been a loss of tax. Understanding the risks and working with HMRC to resolve any concerns is essential to achieving a successful outcome for the client, as this will minimise the disruption, the professional costs and uncertainty.

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