Facing a HMRC investigation: a practical response

Management of taxes | OMB | Large Corporate



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We consider the steps to help you manage a HMRC investigation calmly and competently.

An HMRC investigation or enquiry can be a worrying development for a business but for those in HMRC's 'Large Business Service', it is par for the course. The service covers approximately 2,000 businesses. Roughly half of these businesses are being formally investigated by HMRC at any one time. Some have multiple issues, meaning that there are approximately 2,000 separate cases open.

The 'defence' file

A sensible first step once an HMRC investigation or enquiry is underway, or indeed beforehand, is to start collating all of the necessary information as part of your 'defence' file, if you don't already have it all in place. Not all enquiries or

investigations involve the creation of a formal defence file but assembling this at an early stage will help to unearth all of the relevant issues and give you the ability to properly assess the matter.

There should be several parts to any defence file. The following sections should be considered, several of which will need to be updated regularly as matters progress:

- all factual information such as contracts and documentation, together with the financial information necessary to establish the quantum. This should include supporting evidence, if necessary, of matters ‘on the ground’ (i.e. what happens, when and by whom);
- all professional advice that has been received on the matter (subject to considering matters of privilege);
- all relevant extracts of the legislation, HMRC guidance, manuals and case law;
- any internal decisions on the tax liability and the process that was followed to arrive at that decision;
- correspondence with HMRC, in date order and regularly updated; and
- a timeline with all of the key dates, including appeal deadlines and time limits.

Having all of this information available will make responding to any HMRC queries significantly easier.

The initial assessment

An initial assessment of how best to proceed should then be undertaken once the relevant information has been gathered. This may be a good time for tax advisers to discuss how they would approach managing the issue with HMRC.

Even if on initial assessment you consider that your position is not as strong as originally considered or simply that the tax at stake is not material, it is worth remembering that HMRC will consider a taxpayer’s conduct during an enquiry to determine penalties, with mitigation available for telling, helping and giving.

By contrast, if you consider your grounds to be relatively strong, you may wish to make a proactive submission to HMRC with all the relevant information. For indirect taxes, this can have the effect of starting the clock on the one-year time limit. For direct taxes, it may assist in either accelerating a closure notice or allowing you to apply to the tribunal to direct HMRC to provide one in a timely manner.

One key point to be discussed as part of the initial assessment is the treatment that the taxpayer will adopt in respect of future periods.

Future periods

Filing a tax return usually requires a declaration that the information is correct and complete to the best of the taxpayer's knowledge. Where tax is under enquiry, assessment or appeal, it will usually be on the basis that the taxpayer considers the tax was not due. This can be difficult to reconcile with filing future returns in accordance with HMRC's view.

Notwithstanding this point, there is an inherent discomfort with continuing to submit returns applying a treatment which HMRC has either formally assessed or indicated that it disagrees with. There may be an increased probability of a deliberate penalty in respect of periods after the taxpayer is aware that HMRC disagrees with a position.

In our experience, adopting a consistent treatment is usually the correct approach, where supported by professional advice. This can be accompanied by timely disclosure to HMRC. Consideration could also be given to making payments on account in respect of the uncertain tax payable in order to avoid interest accruing, which can be substantial.

The additional complexity which can be introduced from a mixture of assessments and claims across different periods is significant. A single direction of travel, either assessment or claim, makes the position simpler for both the taxpayer and HMRC, and reduces the risk that relevant time limits will be missed on both sides.

Whilst the taxpayer is filing their ongoing returns, it is likely that HMRC will be proceeding with its formal or informal investigation or enquiry.

Information requests

In order for HMRC to ultimately make an assessment of tax, it will need to receive information to support this assessment.

Where HMRC has requested information, it is worth considering whether the information can be shared with HMRC directly. HMRC frequently makes informal

information requests to businesses in order to help it understand the tax treatment. For many businesses, the immediate reaction is to provide the data to HMRC as quickly as possible and not to query whether HMRC has the right to the information.

Where the data concerns suppliers or customers, however, the business needs to be cognisant of its other obligations. Many supplier and customer agreements have confidentiality clauses which should be adhered to. Whilst these will typically have a specific clause allowing businesses to provide this confidential information to HMRC under a formal information notice, this may not extend as far as responding to an informal request from HMRC.

Managing the relationship with HMRC in this instance is crucial and it may be possible to agree collaboratively with HMRC the specific wording of any information notice.

Where the business has determined that the information shouldn't be provided to HMRC and HMRC has issued a formal notice, the taxpayer should consider an appeal against the information notice so that the tribunal can determine whether the information notice is valid (noting that a notice that was approved by the tribunal before issue does not carry an appeal right).

There are two particular issues that we would highlight in relation to information requests – privilege and conduct.

Third-party conduct

It has become increasingly common for a business to be managing a tax risk which is payable by another party. This could be under a tax indemnity, covenant or, in some cases, specialist tax insurance. Often in return for taking on this risk, there will usually be notification and additional conduct rights regarding how the issue will be communicated with HMRC and managed more generally.

If this is relevant to any tax issue, careful attention needs to be paid to any communications with HMRC on the issue to ensure that you are acting in accordance with the conduct rights established in the covenant or policy.

This can be difficult in practice as the counterparty may wish to adopt a different approach to HMRC than the taxpayer and this can have a detrimental impact on the taxpayer's relationship with HMRC.

Privileged advice

Where advice which has been received is potentially privileged, then care needs to be taken not to inadvertently waive privilege by sharing documents with HMRC. It should be noted that legal advice privilege will only extend to communications between a taxpayer and their legal adviser (note, this does not extend to tax advisers or accountants who are not legally qualified).

By contrast, once litigation is in reasonable contemplation then litigation privilege has a wider scope.

Discussing the matter with the legal adviser who provided the advice to understand how best to avoid waiving privilege is a useful first step. In many circumstances though, there will be good reasons to share the privileged advice with HMRC. In particular, where a taxpayer can demonstrate that they have followed the advice of a reputable adviser, this is likely to impact the penalty position.

The role of the customer compliance manager

As the investigation or enquiry continues, the Large Business Service is slightly different from the normal taxpayer population in that it will have a dedicated customer compliance manager (CCM). Mid-sized businesses can request a temporary customer compliance manager (tCCM) for assistance if they have particularly complex tax affairs or multiple enquiries open at the same time.

Whilst the CCM is not an impartial mediator, they can be particularly helpful in moving enquiries and disputes along. It may be possible to agree a framework for resolving the matter with the CCM or use them as an appropriate point for escalation when progress is not being made with the specialist tax team.

They can be particularly helpful in working to receive a clear view or decision from HMRC. The proposed changes to the tax administration framework (which are open for consultation until 7 July 2025) may assist with this. Under these proposals, the system for direct and indirect taxes would be broadly unified, which would lead to a more consistent approach.

Pre-decision

For indirect taxes, as HMRC is approaching reaching a decision, it may issue a ‘pre-decision letter’. For direct taxes, HMRC may write to provide its ‘opinion’ on the issue. This provides the taxpayer with an opportunity to make further representations in response to the pre-decision or opinion.

HMRC can make a decision without realising it. The First-tier Tribunal case of *Isle of Wight NHS Trust and others v HMRC* [2023] UKFTT 23 held that a short reply to a detailed technical submission noting that ‘[f]or the avoidance of doubt, HMRC does not share the views set out in your letter/report’ was sufficient to constitute an appealable decision. HMRC did not intend to make a decision in that instance but the wording indicated that HMRC had expressed a concluded view.

Expediting matters

From a direct tax perspective, it is possible to apply to the tribunal to request that HMRC is directed to issue either a closure notice or partial closure notice. This can be particularly helpful in requiring HMRC to make a firm decision on a matter and provide a clear view which can subsequently be appealed. The timing of such an application is a delicate matter – generally the tribunal will want to provide HMRC with sufficient time in order to consider the relevant information but ‘fishing expeditions’ and the like are not acceptable.

Whilst indirect tax enquiries do not have a similar process, they have the benefit of firmer statutory time limits in order to raise assessments. HMRC has historically occasionally raised what were described as ‘protective assessments’ to prevent tax going out of time whilst it considered the matter. The First-tier Tribunal case of *Go City Ltd v HMRC* [2024] UKFTT 745 was informative in that HMRC had raised ‘protective’ assessments for VAT; however, in respect of the earliest two periods, it had not yet provided a clear decision to the taxpayer and internal documents confirmed that HMRC had not yet arrived at a clear view that the taxpayer’s return was incorrect.

Where HMRC has issued any assessment, even if described as ‘protective’, taxpayers should be aware that all the usual time limits continue to run so action must be taken promptly.

Statutory review and reconsiderations

Once a final decision has been made by HMRC, the taxpayer will want to consider their options: typically, to accept the decision and pay any additional tax; to move straight to appeal at the tribunal; or to request a review from an independent HMRC officer. It can be beneficial to request a review as the review officer could cancel the decision or vary it in favour of the taxpayer.

If the review officer upholds the original decision, the matter is then likely to require a formal appeal and, in the case of indirect taxes, payment of the tax.

Where additional information is provided, this can lead to a reconsideration of the decision. This is particularly complex if the taxpayer has already commenced a statutory review or appeal.

Alternative dispute resolution

Alternative dispute resolution (ADR) is another option which is worth considering. The Tax Tribunal has just issued an updated statement broadly encouraging the use of ADR. A trained and externally accredited HMRC mediator (who unlike a CCM is specifically there in a role as mediator) works to explore the issues. It is also sometimes possible to appoint a co-mediator.

Even where ADR does not result in an agreed settlement of the issue as a whole, often it has the effect of significantly reducing the number of issues under dispute or debate, and making the matter a much cleaner one to eventually litigate through the tribunal system. This has the result of significantly reducing the costs for both HMRC and the taxpayer. ADR is particularly useful in long-running debates where the matter has become entrenched in correspondence.

Formal appeal

Noting that the initial route of appeal is slightly different for direct and indirect taxes, this is a way to ultimately arrange for an independent tribunal to hear the matter and provide a decision which is binding on both parties.

Typically, at this stage the matter will be handled by the HMRC Legal Group. The taxpayer will need to file their grounds of appeal and HMRC will subsequently file their statement of case. At this stage, the matter is increasingly unlikely to be resolved informally (although ADR is still possible). In some instances, HMRC does reconsider its position where it determines that under its litigation and settlement strategy, it is unlikely to succeed.

Whilst tribunal proceedings can be expensive, they do provide a degree of finality (subject to further appeals to higher courts). Where both taxpayer and HMRC are entrenched or fundamentally disagree on a point of principle, this is the only option. It is helpful to identify if this is the case as early as possible and for HMRC and the taxpayer to present the position as clearly as possible to the tribunal.

Judicial review

As a final note, whilst uncommon, it may also be beneficial to run a tribunal appeal and commence judicial review proceedings simultaneously.

Where a taxpayer considers that they have either been misdirected by HMRC or have acted in a way that appears to be unfair, then the matter may be suitable for judicial review.

This requires an application to the High Court because it is only in limited circumstances, where the appeal provisions directly allow it, that the First-tier Tribunal can consider public law arguments such as legitimate expectation. However, if there is a concurrent tax appeal, it may be possible to have the appeal and the judicial review heard together in the Upper Tribunal tax chamber at first instance.