

Top 5 Mistakes When Handling a Tax Enquiry

(Lecture P1220 – 23.32 minutes)

The list of “mistakes” that I will cover in the session is based on my 25 years’ experience as a specialist tax investigations consultant, and my time before that as an inspector in the Inland Revenue (as it was then called). I have considered the most common issues that I encounter when an accountant or other adviser asks me for their assistance in dealing with a tax enquiry.

Ignoring the basics

It is common, when you receive an enquiry letter from HMRC, for your first consideration to be your response. However, it is sensible to first establish the status of the letter, and whether it is a valid enquiry notice. The statutory enquiry framework is for HMRC to follow, just as much as it is for the taxpayer and their adviser. It is important to be realistic when assessing your level of competence to deal with a tax enquiry, and consider whether specialist assistance should be sought.

Dealing with information requests

Information can be sought by HMRC at any stage of any enquiry, but the first request is usually sent with the opening letter. The relevant legislation (s1(1), Schedule 36, Finance Act 2008) requires that information or documents requested by an HMRC officer must be “reasonably required” for the purpose of checking the taxpayer’s tax position. That phrase is not defined, and what may be reasonable in one case may not be reasonable in another. There is also the issue of timing – what is not reasonable in the opening request, may become reasonable (perhaps after the provision of other information to the officer). A typical example of this is private bank statements.

Where it is accepted that information requested by the officer is reasonably required, it is recommended that the items are given to HMRC in response to an informal request. This is because there can be implications for any resulting penalties if the officer issues a formal information notice.

Relationship with HMRC

I have seen numerous cases over the years where the adviser has been more concerned about “not rocking the boat” with the investigating officer, rather than considering the legislation, or the client’s rights. There can potentially be professional indemnity insurance issues if information or documents have been supplied to HMRC when they were not entitled to them, where the client pursues such an action.

Ultimately, the aim of the adviser should be to establish a professional working relationship with the investigating officer.

Meeting the investigator with the client

In a standard tax enquiry (under the provisions of s9A, TMA 1970 or Para 24, Sch 18, Finance Act 1998), there is not a statutory obligation on a taxpayer to meet with HMRC. My view is that the key consideration in deciding whether to take a client to a meeting with the investigating officer should be whether it is in the client’s interest to do so.

In cases I have seen, the decision to allow the client to meet HMRC, when it was not in the client's interest to be there, has been compounded by a failure to control the client during the meeting, or to intervene when required. Even with suitable preparation for a meeting, the client may say something without considering his response.

As an adviser, you do not know what the inspector is going to ask, and you don't know how your client is going to respond. Failure to intervene, to clarify an officer's question for the client, or the client's response, for example, can have significant consequences in the months after the meeting, and take a long time to undo if an incorrect answer has been given by the client, even where they have done so unintentionally. The situation is even worse where the client has lied to the HMRC officer, and the adviser has not taken suitable remedial action.

The issue of face-to-face meetings is not likely to arise under the current, coronavirus, circumstances, but it will return.

Asking for help

There can be a reticence to seek help when dealing with a tax enquiry. It is, however, important for the adviser to know their limits, and to get help sooner, rather than later. Although I am frequently asked to assist accountants when they receive the enquiry letter, it is sometimes much later in the process. On numerous occasions, I have been asked to assist when the enquiry is already two, three or four years old. The earlier that help is sought, the greater the assistance that can usually be provided, with a better chance of a more significant impact on the outcome of the enquiry. It is, however, never too late to seek help.

It can be sensible to seek a second opinion from an investigations specialist even where the accountant is confident they know the answer to their query. It is always worth seeking advice before responding to HMRC where the client discloses an underpayment of tax arising from their deliberate behaviour or there has been a failure to notify (particularly where these have occurred over an extended period); you have received an extensive, or unusual, information request; or there has been an absence of communications from HMRC over a period of several months (which may be an indication of a potential escalation of their action against your client).

When I speak to accountants, I always advocate a materiality limit of zero before taking advice. That is because although a case may look to be of relatively low level, there may be other issues which have not been identified, and which require further questioning of the client.

Summary

The session considered common mistakes that are made by accountants or other advisers when handling tax enquiries. Dealing with such cases is not rocket science, but there are numerous traps and pitfalls for the unwary. A consideration of the basics, combined with a willingness to seek specialist advice, even if only for a second opinion, can hopefully help readers avoid making the same, or similar, mistakes.

Contributed by Phil Berwick, Director at Berwick Tax Limited