The Personal Tax Planning Review

SELF ASSESSMENT: ANTICIPATING REVENUE CHALLENGES

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Introduction

Inland Revenue enquiries into taxpayers' returns and accounts have traditionally been focused on those in business on their own account, either being self-employed, in partnership, or running their business through a company which they control. This is simply because the scope for avoidance is much greater than for arm's length employees from whom tax is collected at source under the PAYE system. The general thrust of investigations is likely to remain the same under self assessment, although there are significant changes to the Revenue's statutory powers and procedures.

Under the existing system which has been in force since 1977 the Revenue have applied what is usually known as the ERA process in the examination of accounts, under which the accounts are selected for Enquiry, Review or Acceptance. In enquiry cases, the Inspector needs convincing that the accounts are factually correct and complete, and fully reflect the taxpayer's business activities. An enquiry usually involves the Inspector setting out the reasons for the enquiry under arrangements agreed with the Consultative Committee of Accountancy Bodies (CCAB) in March 1977 (TR 246), and he will seek to consider the declared results in the context of the taxpayer's apparent lifestyle and the opportunities for falsification. The procedure usually begins with an early meeting with the taxpayer, followed by the production of such books and records as are available to confirm the taxpayer's return or justify the Inspector's suspicion that there have been errors or omissions. Under this system the Revenue could enforce compliance through raising estimated assessments, against which the taxpayer would appeal and on which the Commissioners would determine. The old precept for information under TMA 1970 s.51 has been replaced with effect from 1st September 1994 by the General Commissioners (Jurisdiction and Procedure)

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Regulations 1994, SI 1994 No 1812, and by the Special Commissioners (Jurisdiction and Procedure) Regulations 1994, SI 1994 No 1811. Under paragraphs 10 of these regulations the Commissioners have power to obtain information, directing the taxpayer to make available for inspection by the Commissioners, or an officer of the Board, "all such books, accounts and other documents in his possession or power as may be specified or described in the notice, being books, accounts or other documents which, in the opinion of the Tribunal, contain or may contain information relevant to the subject matter of the proceedings".

The CCAB Press Release of 25th September 1979, at paragraph 6, averred "the Revenue state that the main use that Inspectors make of gross profit rates and other business ratios is as part of their review when considering whether to accept accounts without enquiry. One reason for starting an enquiry will be a discrepancy between the gross profit percentage shown by the accounts and the percentage the Inspector would have expected to find in the light of his knowledge of the trade and of local conditions. His judgment may be influenced by information in his guidance notes, and for some trades this will include reference to gross profit rates, but he is expected to reach his own conclusions and rely mainly on his own experience and local knowledge. If an enquiry is started, the Inspector will usually want to know more about the way the business is conducted, but there is no question of applying a single notional gross profit rate and insisting that this rate should have been achieved. The Inspector will have regard to the particular circumstances of the business and should give the taxpayer or his adviser the opportunity to explain any apparent discrepancy." A number of the guidance notes have since been published as Business Economics Notes.

The enquiry system seems to have worked fairly well in practice in most cases, although just occasionally an Inspector, having started an enquiry, seems unduly loathed to give it up - e.g. *Scott and another (trading as Farthings Steak House) v McDonald* [1996] STC (SCD) 381.

Under the review procedure the Revenue would make enquiries into specific issues or the tax treatment of specific items of income or expenditure in cases where they thought that further explanation was required but where the underlying veracity of the accounts and computations was accepted.

The accounts which were accepted were subject to written agreement with no further enquiry.

Enquiries under Self Assessment

The Revenue's power to enquire into a self assessment return is provided by TMA 1970 s.9A and extends to an amended return or any claim or election entered in the return or amended return. The Revenue have a fixed period within which they may enquire into the return which, under TMA 1970 s.9A(2)(a), ends twelve months from the normal filing date for a return filed timeously and twelve months from the end of the quarter in which the return is filed, if filed late.

However, once an enquiry has been made and dealt with, a further enquiry cannot be made under this section in view of TMA 1970 s.9A(3).

Not only is it necessary to give notice of the intention of enquiring into a return under TMA 1970 s.9A(1) but it is also necessary for the Revenue to give notice of the completion of the enquiry under TMA 1970 s.28A. These provisions allow the Revenue to amend the self assessment during the course of the enquiry if they think there is likely to be a loss of tax to the Crown, which is normally known as a jeopardy amendment; TMA 1970 s.28A(2). The normal procedure, however, is that once the Revenue enquiries are completed, the taxpayer has 30 days to amend his self assessment under TMA 1970 s.28A(3) and, if he fails to do so, the Revenue may make the appropriate amendment under TMA 1970 s.28A(4). The Revenue may also disallow a claim in whole or part under TMA 1970 s.28A(4A) or (4B). On completion of his enquiries the Inspector has to inform the taxpayer of this in writing under TMA 1970 s.28A(5). If the taxpayer thinks that the enquiries are becoming overly protracted he may appeal to the Commissioners under TMA 1970 s.28A(6). The Commissioners then hear the case in the same way as they would an appeal against an amendment of a self assessment.

Where the taxpayer fails to submit a return at all, the Revenue may make a determination under TMA 1970 s.28C, which has the same effect as if it were a self assessment made by the taxpayer and in fact can be superseded by such a self assessment under TMA 1970 s.28C(3).

It will be seen therefore that the Revenue's powers of enquiry under self assessment follow a much more formal route than previously, and in particular the taxpayer, as well as his agent, if any, has to be informed of the commencement of the enquiries. The Revenue are no longer required to give any reasons for the opening of enquiries, and are adamant that they will not do so, and the March 1977 agreement with the CCAB has no relevance to self-assessment (Revenue Manuals IH 1405). In a small number of cases, i.e. between 7,500 out of nearly 9 million returns likely to be issued, the enquiries will be entirely random, generated centrally by the main Revenue computer. Where a case is chosen at random the Revenue will not necessarily commence enquiries if it is obvious that the return is not worth further investigation, for example if the computer has chosen a return of a 90 year old pensioner with a total income only marginally above the tax threshold. In other cases, however, where a case is chosen for enquiry, the Revenue will wish to examine the underlying records, including bank statements, dividend vouchers, etc, at an early stage. While the random enquiry is considered to be both a deterrent and a necessary check on the integrity of the whole of the assessment system, it has the potential of generating taxpayer disquiet if taxpayers are put to a lot of expense, incurring professional fees to prove the correctness of the return. It is therefore likely that the Revenue will be particularly tactful in such cases. If a taxpayer, who has perhaps been selected for random enquiry and has supplied the Revenue with the appropriate documentary proof, considers that the Revenue are continuing to challenge a return unnecessarily, he has the ability to apply immediately to the Commissioners and ask them to terminate the enquiries. It may be that the taxpayer assumes that he has been selected randomly, but the Revenue have other reasons for looking at the return and these reasons will obviously become apparent in the Inspector's response to the taxpayers's appeal to the Commissioners.

Although the Revenue will not notify the taxpayer whether the enquiry is purely random or not, the vast majority of cases will be selected for enquiry on their merits, as previously, at least in the case of a general enquiry.

The main change, however, is to what are known as "aspect enquiries", where the Revenue are not commencing a full investigation but there are areas where they require further information, or disagree with the tax treatment put forward by the taxpayer. Previously these would have been dealt with informally by a letter to the agent or telephone call, but casual enquiries of this nature are impossible under self assessment. The concern among taxpayers and their agents is that once the Inspector has gone to the trouble of opening a formal enquiry, instead of merely asking the one question he would have done previously, he must consider carefully all possible questions that he could ask, because once having commenced his enquiry on any particular aspect, and brought that enquiry to conclusion, he cannot reopen the case should another matter occur to him, unless he can invoke the discovery procedure under TMA 1970 s.29. The Revenue seem to believe that there is no reason why the introduction of the new self assessment procedures would require Inspectors to ask any more questions in an aspect enquiry than they would have done as a result of the review under the old system.

Record Keeping

Consistent with the much more formal procedures under self assessment, is the requirement for the taxpayer to keep records for the purposes of the preparation of tax returns. Although the specific records needed are not specified, they are defined by TMA 1970 s.12B(1)(a) as all such records as may be requisite for the purpose of enabling the taxpayer to make and deliver a correct and complete return for the year or period. Records must be kept for twelve months following the relevant filing date, for a timeous return, or twelve months from the end of the quarter in which it is filed, for a late return, or until the end of the enquiry period if an enquiry has commenced; TMA 1970 s.12B(1)(b). However, in the case of business records which, as rents are now taxed as a Schedule A business, extends to property income, the records must be kept for five years from the normal filing date, i.e. 5 years 10 months from the end of the fiscal year to which they relate; TMA 1970 s.12B(2). Business records must include all amounts received and expended in the course of the trade, profession or business, and the matters in respect of which the receipts and expenditure take place, and in the case of a trade involving dealing in goods, all sales and purchases of goods made in the course of the trade (TMA 1970 s.12B(3). Copies of records may normally be kept instead of original documents so long as they enable an exact facsimile of the original document to be retrieved, either through optical scanning on to computer, photocopies or microfilm. Original documents are, however, required to be kept in the case of dividend vouchers, taxed income certificates, sub-contractor certificates and foreign tax credit certificates; TMA 1970 s.12B(4) and 4(A). The penalty for failure to keep the required records in respect of any year of assessment or accounting period can be as high as £3,000, although this does not apply for a lost voucher which can be verified by secondary means such as a copy or reference in a bank statement; TMA 1970 s.12B(5) and (5B). Although the Revenue have announced that they will only charge penalties under these provisions in extreme cases, they will continue to take the quality of records into account in assessing penalties following an enquiry which has resulted in an underpayment of tax; EH 681.

There is no penalty where it would have been necessary to retain records solely to support a claim not in fact made in the return; TMA 1970 s.12B(5A). Supporting documents such as accounts, books, deeds, contract notes and receipts also have to be retained; TMA 1970 s.12B(3)(b) and 6(b).

Guides to Keeping Records

The Revenue have published SA/BK4 Self Assessment General Guide to Keeping Records and SA/BK3 Self Assessment Guide to Keeping Records for the Self Employed.

The first of these suggests records that may be required, such as employment records, details from the benefit agency, bank and building society interest statements, dividend vouchers, etc. It also sets out how long the records must be retained and penalties for inadequate records. It goes on to explain which records may be kept in copy form, and those where the original documents are required and then gives examples of the sort of records that the Revenue would expect to be kept by an employee or director, such as his P60, copies of P11Ds, details of share options, taxed award scheme participation and third party benefits. Pensioners are included and recommended to retain P60s, certificates of pensions received and benefit agency details. Those in receipt of interest, dividends or other income from UK savings, investments or trusts should keep bank and building society statements, interest statements, tax deduction certificates, life insurance chargeable event certificates, and details of any trust income. It also suggests that details of any capital receipts such as inheritances should be retained, which would obviously be important in explaining a source of new capital.

The booklet also explains the details needed to support capital gains computations or claims for capital losses. One of the problems concerning the record keeping is in connection with capital losses as there is no provision in the Taxes Acts to agree capital losses prior to 1996/97; *Tod v South Essex Motors (Basildon) Limited* [1988] STC 392. Although some Inspectors have actually agreed losses and are unlikely to resile from that agreement, it does mean that taxpayers may have to keep records of capital losses prior to 1996/97 indefinitely, until the losses are used up by an excess of post-1996/97 gains over losses.

The booklet suggests records needed for other UK income or foreign income or gains and the documentation necessary to support claims for personal allowances and other deductions or reliefs.

Expenses reimbursed by employers are an obvious potential problem as the original records will be submitted to the employer for reimbursement of the expenses. The booklet, addressed to the taxpayer, states "you will need to have kept the broad details of these expenses in order to complete your expenses claim and to support your claim if the Tax Office should make an enquiry. You will not be expected to keep photocopies of bills (although you may find it helpful to do so). Normally any enquiries will be satisfied by the production of your own records. But if you need to retrieve any original records from your employer and have difficulty in doing so you can ask the Tax Office to approach your employer on your behalf."

The Guide to keeping Records for the Self Employed SA/BK3 is aimed at small businesses and specifies how long the records have to be kept and the records which will normally be needed, and the penalties for inadequate records. It gives a number of specific examples of documents, books and records expected and gives examples of the records expected from a small retail shop, a labour only sub-contractor and a small manufacturing business.

Production of Documents

The Revenue's powers to call for documents under self assessment is contained in TMA 1970 s.19A under which the Revenue may serve a notice in writing on the taxpayer requiring him, within a reasonable time, of not less than 30 days, to produce documents in his possession or power, which the Revenue may reasonably require for the purposes of determining whether, and if so, the extent to which, the return is incorrect or incomplete, and to furnish such accounts or particulars as may reasonably be required for that purpose, which may entail the taxpayer or his agent obtaining or creating new documents, e.g. reconciliations; EH 394. There is an exception for documents required for an appeal, and the notice requiring the production of documents may itself be appealed against; TMA 1970 s.19A(5) and (6).

A problem often arises in practice in connection with the production of books and records to support a tax return in that the taxpayer may well keep the books and documents, such as invoices, but the taxpayer's agent makes adjustments in the preparation of the final accounts from the original records. These adjustments may be recorded only in the agent's working papers, but may be essential to link the prime records with the accounts and tax returns. Such records are available to the Revenue by following the procedures under TMA 1970 s.20(3), subject to the restrictions for audit papers or tax advice papers under TMA 1970 s.20B(9); IH 8098. As these link papers may have to be disclosed, it is obviously sensible to keep them separate from the audit and advice papers.

Where a tax accountant has been convicted of an offence in relation to tax, or has had a penalty imposed on him under TMA 1970 s.99 for knowingly assisting in the preparation of an incorrect return, he may have to make all his papers available to the Revenue under TMA 1970 s.20A. Statement of Practice SP5/90 sets out the Revenue's practice in connection with accountants' working papers.

Code of Practice 11, Enquiries into tax returns by local tax offices.

The code of practice governing district enquiries is set out in COP 11 which emphasises the Revenue's commitment to ensuring that taxpayers pay the right amount of tax, no more no less. This explains the Revenue procedure on receipt of the taxpayer's return, including the return correction procedure previously referred to as "repairs". Under this procedure the Revenue may, within nine months of the return being sent to them, correct obvious errors in the return, such as arithmetic errors, and inform the taxpayer of the corrected figures. The correction procedure takes place under TMA 1970 s.9(4)(a) and any error or problem identified that cannot be corrected in this way must be dealt with by means of a formal enquiry under TMA 1970 s.9A. If the taxpayer disagrees with the correction he may file his own amendment to correct the errors identified within 12 months of the filing date, for a timeous return, so long as Revenue enquiries under TMA 1970 s.9A have not commenced; TMA 1970 s.9(4)(b).

COP 11 sets out what happens when the enquiry is started, how the taxpayer may obtain or change his professional representation, if any, and explains the procedure for providing information and the procedure of meetings. The booklet makes it clear "you are not obliged to come to any meeting but we will expect you to provide, promptly, any information we consider essential to our enquiries. Meetings allow you to clarify and explain any point you think we may not have understood and allow you to ask questions as well. If we consider that correspondence will not be an adequate substitute for a meeting we will make this clear to you." It also states "we will make a written record of any meeting we have with you and you can ask for a copy. We may ask you to sign a copy of our notes to show that they record the substance of what was said. You have the right to comment on these notes and to tell us about anything with which you do not agree. You do not have to sign them or comment on them but a signed record could be useful if you cannot reach agreement and have to ask the Appeal Commissioners to resolve matters." It is for this very reason that taxpayers' agents often advise taxpayers not to sign notes of meetings but to make their own notes of what took place. Taxpayers' agents would normally advise against attending meetings at an early stage in an enquiry, until they have ascertained the nature of and reason for the enquiry, but it is impossible to lay down any hard and fast rules in relation to meetings. In simple cases they can be the easiest way to resolve matters and in most investigations there comes a time where a meeting between the taxpayer and the Revenue becomes appropriate, as otherwise the Revenue may allege non co-operation; EH 308.

COP 11 comments on paying tax during the course of enquiries if an error is found, to reduce interest charges, and the power to make a jeopardy amendment is mentioned.

An attempt is made to agree the revised figures, and, in the absence of an agreement, the appeals procedure is set out. The liability for interest, surcharge and penalties is summarised and reference is made to a certificate of full disclosure at the end of enquiries. The warning is given "we will take a very serious view if you sign a certificate of disclosure you know to be false so you should consider it carefully before signing." By "serious view" the Revenue mean that they will consider prosecution where a certificate of disclosure subsequently turns out to have been knowingly incorrect.

The taxpayer's rights under the Taxpayers' Charter and complaints procedures are also summarised.

District Enquiries

In the case of a normal district enquiry, other than a mere aspect enquiry, the Revenue will make a full review of the return, the taxpayer's compliance history and any third party information. They will identify the information needed to check the correctness and completeness of the return and, where the taxpayer is carrying on a business, this information will invariably include the business records. It may also include other information, such as private financial records including bank statements, taxed income vouchers etc. The Revenue Enquiry Handbook is published on CD-ROM; Inland Revenue Press Release, 20th March 1997.

The enquiry commences with the notice of enquiry required by TMA 1970 s.9A, together with a request for all the information thought to be required, such as the business records. If that information is not forthcoming a notice requiring production of the information will be issued under TMA 1970 s.19A. In business enquiries of any substance the Revenue may suggest examining the records and having a meeting with the taxpayer at the business premises, provided that the taxpayer so agrees. In many cases the taxpayer, if professionally represented, would be advised to resist such a suggestion and arrange for the business records to be examined in the agent's premises where it is not practical to send the papers direct to the Revenue. The Revenue have no power to demand a site visit other than with an appropriate judicial authority on a sworn statement by an Officer of the Board who is granted a search warrant enabling the Revenue to enter premises and seize and remove evidence of a serious tax fraud. It is not necessary for such a warrant to specify the suspected document to be seized (*IRC v Rossminster Limited and others* [1980] STC 42 nor need they name the Board Officers concerned *R v Hunt* [1994] STC 819). The appropriate judicial authority in England is a circuit judge. Where documents are removed under such a warrant the Revenue must, if requested, provide a record of them and must not retain them longer than is necessary to copy them, unless the originals are needed as evidence in a trial or for examination. These proceedings under TMA 1970 ss.20C, 20CC and 20B are only used very rarely in cases of suspected serious fraud; IH 5101.

If the Revenue, as a result of the information they receive, decide that they require further information, they will make the appropriate request for it. They will then draw their conclusions as to the amount of tax underdeclared, if any, and present these to the taxpayer. These proceedings may be subject to negotiation to arrive at an agreed settlement and the Revenue may suggest that this may best be done at a meeting with the taxpayer and his agent. Many agents will prefer to attend the meeting without the client present, and accede to a final interview only when all matters in dispute have been satisfactorily resolved. Where tax has been underpaid, it may be settled by a contract settlement, under which the taxpayer agrees to pay a certain amount by way of tax, interest and penalties in consideration for the Revenue taking no further action as a result of the incomplete return. In less serious cases the Revenue may merely request the taxpayer to amend his self assessment under TMA 1970 s.28A or themselves amend the self assessment under these provisions. In such cases the taxpayer has the normal right of appeal against the amended assessment.

Obviously at any stage in an enquiry, if the taxpayer has understated his tax, his co-operation in admitting this fact and appointing a competent agent to arrive at the correct figures will be reflected in a reduced penalty at the end of the day.

Once the Revenue have started a general enquiry the taxpayer has little option but to lie back and enjoy it, and provide the Revenue with the information requested, attend meetings and try and resolve the problems as cheaply as possible; or to resist the attack, obtain professional advice and engage a competent agent to handle the case in the most effective manner possible, with a view to convincing the Revenue that the accounts are correct or, in cases of default, agreeing a negotiated settlement as expeditiously and fairly as possible.

Preventing an Enquiry Starting

Taxpayers are likely to be concerned that, if there is any aspect of the return that causes the Inspector to have any concerns, he may commence a full enquiry or look very closely to see how many particular aspects of the return he should enquire into, and it is obviously in the taxpayer's interest to try and anticipate areas where the Revenue are left with no real option but to commence enquiry procedures in order to explain matters not apparent from the return. The Revenue require all self-employed businesses with a turn-over in excess of £15,000 per annum, and practically all partnerships, to complete what is generally known as the standard accounts information section of the return and supplementary pages. The standard accounts information gives the Revenue statistical information, compared with other similar businesses, and also compares the results with previous years. Abnormalities will be identified by computer to assist the Inspector in determining which returns to open up for enquiry, and it is obviously in the taxpayer's interest to ensure that anomalies are avoided where possible.

This involves completing the standard accounts information on a consistent basis, year on year, and to use the white space information on the return, or an accompanying letter, to explain the causes of variations that are otherwise not readily apparent.

The Revenue obviously look to items such as gross profit, and how this compares with industry norms and previous results, and how the results compare with similar businesses in the locality. This procedure is no different from that carried out at present, except that the computer aided identification may pick up cases that might otherwise be missed.

In particular, the Revenue are likely to enquire into a return where the income looks low, compared to a reasonable return on capital employed, previous earnings from the business, previous earnings from employment where the business has commenced recently, and the results appear inconsistent with the taxpayer's apparent life-style, including his pattern of investment.

The taxpayer who has a history of non-compliance, either in his own affairs or in the PAYE of his employees or in his VAT returns, is more likely to be identified for enquiry, as is a taxpayer using what the Revenue regard as an unreliable agent. Unfortunately, the taxpayer may be unaware of the reputation of his agent in the local district, and this may present the taxpayer with unforeseen difficulties. It is a sad fact that in spite of the professional bodies' assiduous attempts to enforce proper ethical standards on their members, a small number of agents perform very poorly. As in other aspects of life the cheapest is not normally the best, but paying substantial fees does not, of itself, guarantee good performance in an agent.

The Revenue obtain considerable quantities of third party information in relation to taxpayers, in particular interest on deposits, but items such as rating lists and auction returns are also sent to the Revenue. Jealous neighbours, dissatisfied customers and former employees are a common source of information for the Revenue and although "sneaking" in this fashion is not normally regarded as a particularly laudable activity, nonetheless the Revenue have a duty to consider whether allegations of this nature are well founded, and they can be a triggering event for an enquiry.

There are also occasions where an investigation into close business associates might point the finger at the taxpayer, and investigations locally into the conduct of various trades or professions and "golf club talk" may suggest, for example, that for some mysterious reason cremation fees paid in cash are not subject to tax, and such views, if widely held, can constitute a fruitful source of Revenue enquiry.

It is also not unknown for sophisticated tax avoidance, involving complex arrangements, to be poorly implemented, with corners being cut for ease of operation, which might mean that profits are not protected from taxation in the light of what actually happened, even though they might have been had the plan been properly implemented.

Clearly, where the taxpayer is in receipt of substantial gifts, legacies, distributions from trusts, etc, it is in his interest to notify the Revenue of this in the white space on his tax return, to account for the resultant increased investment income.

In order to reduce the likelihood of an enquiry, it may be sensible to err on the side of over disclosure rather than force the Revenue into having to make an aspect enquiry. In particular it may still be sensible to enclose accounts and computations giving rather more information than the somewhat attenuated details of the standard accounts information. In most cases, where there are notes to the accounts explaining accounting policies and where the accounts are audited or professionally reviewed, it may be sensible to submit the full accounts and computations. If, however, the accounts are merely an income and expenditure account adding nothing to the information included in the standard accounts information there is no need to submit the accounts merely because they may have been prepared for the bank and are available.

Disclosure and Discovery

TMA 1970 s.29 enables the Revenue to raise an additional assessment, which would otherwise be out of time, where the taxpayer is guilty of fraudulent or negligent conduct, or where an officer of the Board could not have been reasonably expected, on the basis of information made available to him before that time, to be aware of the fact that profits have been under-assessed; TMA 1970 s.29(5). This does not apply where the return was made in accordance with practice generally prevailing at the time when it was made; TMA 1970 s.29(2). For the purposes of discovery, the statute provides that information is made available to an officer of the Board if it is contained in the taxpayer's return or any accounts, statements or documents accompanying the return, for the chargeable period, or either of the two immediately preceding chargeable periods, or it is contained in any claim made for the relevant chargeable period, or accompanying documents, or it is contained in other documents, accounts or particulars produced to the Revenue, or it could reasonably be expected to be inferred from the information made available, or was notified in writing to the Revenue; TMA 1970 s.29(6). The statutory provisions are explained in the Inland Revenue Press Release of 31st May 1996, and Tax Bulletin issue 23, June 1996, page 313. In addition to making a plea not to send unnecessary information to the Revenue, this guidance confirms that the standard accounts information has to be completed in all cases except partnerships whose annual turnover exceeds £15m, which will be examined every year as a matter of course, and the submission of accounts and computations may not add anything to the information already in the return. Sending additional material beyond the return, accounts and computations should only be done where it is both relevant, and the relevance is specifically explained to the Revenue, as they cannot reasonably be expected to plough through lengthy documentation, the relevance of which has not been brought to their attention.

Under self assessment it will be possible for approved agents to submit returns directly to the Revenue, under the electronic lodgement system. Lodging the return electronically obviously cuts down the time the return is in the post and eliminates errors of transcription. It also has a number of advantages for the approved agent in that, for example, he will be able to obtain copies of taxpayers' statements not otherwise available. Although the electronic lodgement system is capable of taking considerable quantities of additional information, including accounts and computations, the Press Release makes it clear that, so long as the return refers to accounts and computations being sent, these will be treated as documents accompanying the return provided that they are submitted, by post or hand, within one month of the return being sent electronically.

Estimates in Accounts

In *Dunk v Havant Commissioners* [1976] STC 460 the taxpayer appealed against the award of penalties for the non-submission of tax returns. The taxpayer argued that, under TMA 1970 s.8, he was required to make a return which, to the best of his knowledge, was correct and complete. The taxpayer could not afford professional help and had lost certain documents and therefore argued that if he were to make a return it could not be correct and complete and therefore he would be liable for penalties for an incorrect return.

This did not impress Goulding J, who stated:

> "What the taxpayer has to declare is that the return is, to the best of his knowledge, correct and complete. If . . . a taxpayer finds particular circumstances that make the best of his knowledge more than usually unreliable, it is open to him to put against his figure for a particular item of income such words as "estimated, see accompanying memorandum" or something of that kind, and explain the circumstances. If he has done his best, and of course he is under a duty to use all proper sources of knowledge, he will not, in my view, be guilty of making a false statement,

> providing, as I say, he puts in a genuine estimate and, if necessary, explains that it is not very reliable."

On the basis of this decision the Revenue suggest that where records have been lost or destroyed or there are insufficient records or information to reach a reliable judgment on the apportionment of an expense, estimates, to the best of the taxpayer's knowledge and belief, would be accepted, provided that the circumstances were explained to the Revenue.

However, most business accounts contain estimates of some kind or another and it is not necessary to inform the Revenue that the accounts include such estimates, provided that they are reasonably reliable estimates.

Such estimates fall into various categories, such as recurrent payments where details of a particular payment such as a quarter's electricity charge is missing, and has been estimated with a reasonable degree of accuracy. Secondly, there may be cash payments where detailed records have not been kept such as the purchase of trade journals, taxi fares and tips. Thirdly, the private proportion of business expenses with a private element are usually estimated on the basis of a roughly calculated apportionment based on estimated mileage, number of available rooms in a house partly used for business purposes, the estimated private usage of telephone equipment, etc. Finally, there may be unidentified receipts, which are assumed to be business receipts in the absence of evidence to the contrary, and such working assumption is acceptable to the Revenue without specific notification.

The Revenue distinguish, quite properly, between records which are less than perfect but which enable accounts to be prepared with a reasonable degree of accuracy, and records that are wholly inadequate such that the figures are little better than guesses, in which case the Revenue should be informed of the reason for the inadequacy and the steps being taken to prevent its recurrence.

Provisional Estimates

In certain cases, information to prepare a complete and proper return is not available at the time by which the return has to be delivered, but the information is expected to become available in due course. This might include, for example, dividends declared by overseas companies, distributions from foreign trusts, or income from overseas estates in the course of administration. In such cases it is perfectly proper for the taxpayer to indicate the source of income and a provisional estimate in accordance with the best information to him of the likely income expected to arise. This figure will be used for self assessment purposes, and the taxpayer will not be liable for penalties for an incorrect return, provided that the reason for the provisional figure is explained and the correct figure is notified to the Revenue as soon as it becomes available. At this point an additional assessment or repayment will be made together with an interest adjustment as appropriate. It is, however, necessary to make an estimate, as merely to insert "to be ascertained" would result in an incomplete return, which would have to be rejected, leading to possible penalties for not submitting the return on time.

Valuations

A third and quite distinct area requiring judgment in the preparation of figures used in a tax return relates to a valuation, which will often be required for capital gains tax computations. Valuation of assets such as land and shares in unquoted companies is an art rather than a science and an area where there is room for a substantial difference of professional opinion, even among experts, as to the open market value of such assets in hypothetical circumstances. Valuations may also be required for accounts purposes in the valuation of stock, at the lower of cost or net realisable value. In many cases stock adjustments will not require specific notification to the Revenue, as they would fall within the definition of estimates used in preparing accounts which are reasonably reliable.

In the case of specialist valuations, where the taxpayer is unlikely to have the requisite specialist knowledge, it may be necessary to obtain a professional valuation from a surveyor or valuer in the case of land, or an accountant or share and business valuer in the case of unquoted shares, but the size of the transaction and the amount of tax at stake would also be relevant. It would be unreasonable for the Revenue to expect a taxpayer to go to the trouble and expense of obtaining a professional valuation for shares worth a few hundred pounds or where a used car is given to an employee or furniture provided together with living accommodation.

Provided that the taxpayer has taken proper care in the preparation of his return he will not be penalised for a valuation that is subsequently agreed by negotiation with the District Valuer or the Shares Valuation Division of the Inland Revenue in a different figure. Tax would be payable by reference to the finally agreed figure and any interest adjustment made. If, on the other hand, the taxpayer merely put a wild guess as the basis of his valuation without taking professional advice or without supplying the valuer with the information necessary to make a proper valuation, the Revenue could well regard the return as being made negligently and seek penalties if the tax under-declared was material.

In straightforward cases it may be possible to submit details of disposals requiring valuations to the Revenue prior to filing and ideally to agree the figures to be submitted before the final filing date for the return. Even where it is not possible to agree figures by this time, the dialogue with the Revenue valuation department will have commenced, leading to a speedier resolution of an acceptable valuation with the subsequent reduction in any interest adjustment; see Inland Revenue Press Release 4th February 1997.

In the absence of a pre-filing agreed valuation it is probable that in all cases involving a material valuation the Revenue will have to open enquiry proceedings even where the valuation is the only point in dispute.

Interest

The rates of interest on late and overpaid tax are set out by the Taxes (Interest Rate) (Amendment No 4) Regulations 1996 (SI 1996 No 3187), as explained in the Inland Revenue Press Releases of 12th November and 18th December 1996. The formula for calculating overdue income tax and capital gains tax from 31st January 1997 is an average of the base rates of six main banks rounded to the nearest whole number plus 2.5%, currently 8.5%. The interest on all overpaid tax uses the same reference rate, less 1%, less notional tax of 20%, which currently gives a rate of 4%. Under self assessment interest runs from the due date of payment of the tax and repayments from 1996/97 run from the actual date of payment or deemed payment. The interest (repayment supplement) on overpaid tax may require the tax overpaid to be allocated, in which case it will be first to the final balancing payment, if any, secondly to interim payments equally and thirdly to tax deducted under PAYE or otherwise at source. Tax so deducted at source is deemed to be paid on 31st January after the end of the tax year for repayment supplement purpose; Inland Revenue Press Release 12th November 1996, Self Assessment - Calculation of Interest on Overpaid Tax, paragraph 5.

Surcharges

Surcharges are imposed by TMA 1970 s.59C and amount to 5% of the tax payable on the final balance due on 31st January if not paid by 28th February (TMA 1970 s.59C(2)). A further surcharge of 5% of the unpaid tax is payable following the expiry of six months from the due date under TMA 1970 s.59C(3). Notice of the imposition of a surcharge has to be served on the taxpayer and may be appealed against within 30 days, where, throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax; TMA 1970 s.59C(5) to (9). The inability to pay the tax will not be regarded as a reasonable excuse; TMA 1970 s.59C(10). The Revenue, however, have power, at their discretion, to mitigate any surcharge under TMA 1970 s.59C(11).

Reasonable Excuse

As shortage of funds is, statutorily, not a reasonable excuse and the Revenue will not accept that the return not having been sent in is a reasonable excuse, nor non payment to the Revenue where other bills have been paid and the taxpayer remains competent to manage his private and business affairs, it is difficult to see quite what would be accepted as a reasonable excuse. The Revenue have suggested that a fire or flood at the Post Office causing the cheque to be lost in the post might be accepted, so long as payment was made promptly once it was known that the cheque was lost. Errors in making out the cheque would not be accepted as an excuse and illness must be so serious as to prevent the taxpayer from paying, such as coma, major heart attack, stroke or other serious mental or life threatening illness. The illness has not only to be serious but to last from shortly before the due date of payment until the date the surcharge was imposed. The serious illness of a close relative or spouse is unlikely to be accepted as a reasonable excuse and even a long spell in hospital or convalescence should not prevent payment in most circumstances. If stress was caused by bereavement, it could be a reasonable excuse for a short time, but the taxpayer's death would only be accepted if the taxpayer died on or close to the due date for payment, as otherwise the personal representatives would be expected to make arrangements to pay the tax due. A loss of records through flood or fire would only be accepted as a reasonable excuse if the return had not been completed and the Revenue were informed by the deadline for filing the tax return, and a reasonable estimate of the tax due had been paid.

Penalties

Penalties for failure to make a return for income tax and capital gains tax are dealt with by TMA 1970 s.93, with a fixed penalty of £100, TMA 1970 s.93(2), which, on an application by the Revenue to the General or Special Commissioners, can be increased to a further £60 per day; TMA 1970 s.93(3). If the return is more than six months late there is a further penalty of £100 under TMA 1970 s.93(4), and if the return is 12 months or more late the taxpayer may have a penalty of up to 100% of the tax which would have been shown by the return to be due; TMA 1970 s.93(5). Penalties for failure to lodge the return may be appealed against on grounds of reasonable excuse; TMA 1970 s.93(8). Broadly similar penalties per partner are made for failure to make a partnership return, under TMA 1970 s.93A. The Revenue are likely to regard reasonable excuses for penalties for late filing in the same light as reasonable excuses for surcharges, and in particular will not accept as reasonable excuses the fact that filling out the return is too difficult for the taxpayer, or that he has other productive work to do, or that the failure is not his fault but that of his agent, or that he does not have the information necessary, or that the Inland Revenue did not remind him that the return is due.

Penalties for incorrect returns or accounts are levied under TMA 1970 s.95 and, in the case of a partnership, under TMA 1970 s.95A. The maximum penalty is the difference between the amount of tax actually paid or deducted and the amount due. These provisions apply where the return is made fraudulently or negligently. If the return is incorrect, other than through fraud or negligence, it can become negligence if the error is not corrected without unreasonable delay; TMA 1970 s.97. Other penalties may be levied for failure to produce documents (TMA 1970 s.97AA), for special returns (TMA 1970 s.98), but only one tax geared penalty will be levied; TMA 1970 s.97A.

TMA 1970 s.102 gives the Revenue discretion to mitigate any penalty. The levying of a civil penalty does not prevent criminal proceedings (TMA 1970 s.104), and the fact that monetary penalties are normally accepted does not mean that the taxpayer cannot be prosecuted on any evidence produced on the assumption that a pecuniary settlement might be accepted; TMA 1970 s.105. This results in what is known as the "Hansard Procedure" referred to in the Inland Revenue Press Release 18th October 1990 which states "the practice of the Board of Inland Revenue in cases of tax fraud is as follows:

> The Board may accept a money settlement instead of instituting criminal proceedings in respect of fraud alleged to have been committed by a taxpayer.
>
> They can give no undertaking that they will accept a money settlement and refrain from instituting criminal proceedings even if the case is one in which the taxpayer has made full confession and has given full facilities for investigation of the facts. They reserve to themselves full discretion in all cases as to the course they pursue.
>
> But in considering whether to accept a money settlement or to institute criminal proceedings, it is their practice to be influenced by the fact that the taxpayer has made a full confession and has given full facilities for investigation into his affairs and for examination of such books, papers, documents or information as the Board may consider necessary."

In practice, following this procedure, where the taxpayer has had what is known as a Hansard leaflet read to him and he then co-operates, the Revenue have not been known to prosecute. A recent example of the Revenue prosecution policy was demonstrated in *R v Charlton and others* [1996] STC 1418 where the taxpayers' advisers were prosecuted for cheating the public revenue in setting up alleged frauds from which the taxpayers benefited, but the taxpayers themselves escaped prosecution under the Hansard procedure.

Special Compliance Office Enquiries

The old Inland Revenue Special Offices and Enquiry Branch have been merged into the Special Compliance Unit and complex enquiry cases, where serious fraud is not suspected, are dealt with as Special Compliance Unit Investigations under Code of Practice 8, and cases involving suspected serious fraud are dealt with as Special Compliance Unit Investigations under Code of Practice 9. Both these codes are being revised for self assessment.

Both codes deal with such matters as opening the investigation, the position of meetings and notes of meetings, and it is made clear that where a self assessment tax return is under enquiry the taxpayer cannot amend the return, but should nonetheless tell the Revenue of changes that should be made, which will be taken into account in mitigating any penalties at the end of the investigation. Reference is made to keeping the taxpayer informed, providing information and records, payments on account, rights of appeal, interest, surcharge and penalties and the conclusion of the investigation, together with a warning that a taxpayer making statements known to be false may be prosecuted. COP 9, dealing with suspected fraud cases, sets out the Hansard policy with the warning that deliberate failure to admit any irregularities or to make a disclosure of them or the submission of a false certificate or statement might lead to prosecution. The standard questions under the Hansard procedures are:

1. Have any transactions been omitted from or incorrectly recorded in the books of the company?

2. Are the accounts of the company as supplied to the Revenue correct and complete to the best of your knowledge and belief?

3. Are all the taxation returns of the company correct and complete to the best of your knowledge and belief?

4. Are your own personal tax returns correct and complete to the best of your knowledge and belief?

Normally, the taxpayer who is being justifiably investigated, will be advised to answer "yes, no, no and no" to the questions and to commission a report from a firm experienced in dealing with Special Compliance Unit fraud enquiries of this nature. The timetable for the disclosure report so commissioned will be agreed with the Revenue, and it is obviously prepared at the taxpayer's cost. It is clearly in the taxpayer's interest to show full co-operation as not only will this mitigate penalties, it will, in practice, avoid prosecution. Hansard procedures are not used at district level; EH 305.

The theory is that once the taxpayer has been caught he will divulge everything to his adviser, who will complete the disclosure report and negotiate the minimum penalties, in addition to the tax and interest, with the Revenue. In practice it is rather more difficult as the truth usually has to be extracted from the taxpayer, painstakingly, over a protracted period, but it is important for the taxpayer's own protection that the report is correct and complete, so far as it possibly can be, given the period of time it covers and the records available.

COP 9 then refers to keeping the taxpayer informed, providing information, records, payments of account, appeals, interest, surcharge and penalties and the conclusion of the investigation. Reference is made to a certificate of full disclosure which the Revenue will require if there have been errors or omissions in the accounts or tax returns. The Revenue will usually prosecute a taxpayer who has signed a certificate of full disclosure which subsequently proves to be false.

Fees

The costs of professional advice in cases of Revenue enquiry can be substantial, and, in the case of an enquiry by a Special Compliance Office into cases of suspected fraud, very substantial. Taxpayers may insure against the costs of some Revenue enquiries, but not against the results of their own fraud. Because taxpayers usually resent Revenue enquiries at the best of times, particularly when they have a guilty conscience, they may be very loath to pay such costs, and professional advisers specialising in enquiry cases normally, as a matter of course, ask for payments on account of fees prior to accepting the investigation and keep in credit at all times. This is much less easy to do where the taxpayer is a long-established client who may feel, whether justifiably or not, that his agent has somehow let him down by the mere fact that he has been caught supplying erroneous information. To suggest that such a client should now make payments in advance is to add insult to injury and it requires a good deal of tact to explain the firm's policy on investigation cases. It may, in fact, be necessary to continue to provide services on credit but to render bills on an agreed basis, say monthly.

Conclusion

The best way of avoiding the pain caused by Revenue enquiries is to try and prevent them happening in the first instance, by providing the Revenue with correct and complete returns and accounts and such additional information that is necessary for the proper understanding of the taxpayer's affairs. This does not necessarily mean agreeing with the Revenue's known or likely interpretation in all cases, but if the facts are clearly presented to the Revenue, any disputed points of tax treatment can probably be confined to an aspect enquiry if not immediately accepted. No action will prevent a genuine random enquiry and these can only be dealt with by providing the information, with the prime records required, as expeditiously as possible.

It has sometimes been suggested that it is better to submit returns at the latest possible date, but whether returns are submitted as late or as early as possible will not make one whit of difference to the chances of the return being chosen for investigation, as it will probably be in the April following the 31st January filing date that returns will be chosen for enquiry. Returns submitted late may, however, qualify for additional scrutiny and the best result is likely to be achieved by the taxpayer and his agent being as helpful as possible to the Revenue and submitting the returns in good time with such additional information, if any, as is needed for the Revenue's proper comprehension of the taxpayer's affairs.

It may or may not be appropriate to ask the Revenue to compute the tax, but this will have no bearing on whether or not a case is chosen for enquiry. It is likely to be in the best interest of the taxpayer, the agent and the Revenue to try and ensure that self assessment works as smoothly as possible and unnecessary enquiries are limited.