

Business Records Checks
Response to HM Revenue and Customs consultation

1. Executive summary

- 1.1. We support Business Records Checks in principle, but with a view to them being primarily an educative rather than punitive process. It is in those terms that we frame this submission and stress that the checks should consider how the taxpayer might be supported both to pay the right tax, and to claim their entitlements in full (in tax terms and HMRC-administered benefits).
- 1.2. We recommend that penalties should only be levied where the taxpayer can be identified as wilfully failing to keep proper records (with or without attempted concealment). Those who have sought to comply but still made mistakes or who have lacked awareness or misunderstood the rules should be helped in future compliance. After all, penalties cannot deter ignorance.
- 1.3. Ideally, any proposed tiered system of levying penalties should be fully consulted on and built into primary legislation through the 2012 Finance Bill rather than merely expanding HMRC guidance on Section 12B(5) of TMA 1970.
- 1.4. We recommend that HMRC staff training and guidance (both internal and external) in relation to checks is produced in full consultation with stakeholders. This should include the agent community and those such as ourselves who seek to look after the interests of those who cannot afford to pay an adviser. Ensuring that taxpayers fully understand appeal rights and limitations on HMRC's powers is paramount.

- 1.5. Disability and equality aspects of the proposed changes need further consideration and should be the subject of a full impact assessment. Understanding the taxpayer's individual circumstances and abilities is vital in determining both the level of any penalty which may or may not be appropriate and how the taxpayer can be supported in terms of remedial action.
- 1.6. Our intention in this submission is to offer constructive comments so that publicity surrounding these checks is handled in the right way. HMRC's strategy will be self-defeating if, in putting out threatening messages, the 'willing' taxpaying public are frightened and thus deterred from seeking help where they need it.

2. Introduction

2.1. *About us*

- 2.1.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.
- 2.1.2. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

2.2. *General comments*

Numbers of unrepresented taxpayers

- 2.2.1. We comment on this consultation from the perspective of the low-income, unrepresented, self-employed taxpayer. We are interested to note that the current consultation document states (para 4.38) that 'The vast majority of SMEs are represented by tax agents...'. This seems to divert attention from the significant minority which are unrepresented – estimated by HMRC at the time of the consultation on compliance checks changes to be 25%¹.
- 2.2.2. These taxpayers are wholly reliant on guidance and support from HMRC in terms of understanding their tax obligations. We would welcome a process of pre-return checks which seeks to acknowledge this and ensure businesses are helped to comply.

¹See 'Modernising Powers, Deterrents & Safeguards: A New Approach to Compliance Checks', Responses to Consultation and Proposals: 10 January 2008 (para 5.27: 'Moreover, about a quarter of business taxpayers do not have an agent to assist them...')
http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PRO D1_028282

Deliberate behaviour versus innocent error

- 2.2.3. We are however concerned that the consultation largely bases the suggested strategy on the premise that poor record-keeping is deliberate behaviour, using phrases such as ‘There will be those for whom keeping proper records is an unwelcome chore that they would rather avoid.’ (para 4.15); and ‘... that there is no need to change behaviour in relation to poor record keeping unless and until one has been caught out at least once.’ (para 4.27). Penalties are suggested where ‘significant failures’ are identified.

Educational objective of checks

- 2.2.4. The above presumptions seem to go against previous HMRC undertakings to use pre-return checks as a means of educating taxpayers and encouraging them to comply and the best means of so doing¹. Whilst we accept that some choose not to comply, we believe that many unrepresented taxpayers fail to keep adequate records not because of wilful non-compliance, but rather from misunderstanding or being unaware of the rules.
- 2.2.5. We therefore recommend that more focus is given to the educational aspect of the process and that staff training and guidance should reflect clearly this objective. Indeed, as much emphasis should be placed on identifying where the taxpayer may be failing to keep records which could lead to under-claims to certain tax reliefs and other HMRC-administered benefits as it is to seeking out potential Exchequer loss.
- 2.2.6. Moreover, such an emphasis would reinforce the positive aspirations in HMRC’s Charter (see particularly Your Charter², Right 2) and Vision³ to assist taxpayers.

3. Consultation questions

- 3.1. ***Question 1. The record keeping requirements - Do we need to go further than what is available from the factsheet and the evaluation tool; and if so, what else is needed?***
- 3.1.1. Information is not information unless it reaches and is understood by its intended audience. We must therefore consider how taxpayers are made aware of the existence of the factsheet and online tools. Merely making guidance available does not mean it has been accessed and digested, so checking records should also involve understanding why the

¹ Ibid, para 5.29: ‘Where appropriate, HMRC would look to provide advice and education. In this way HMRC would be seeking to help taxpayers understand what they needed to do to take reasonable care in completing their tax returns in future.’

² See <http://www.hmrc.gov.uk/charter/charter.pdf>

³ See <http://www.hmrc.gov.uk/about/hmrc-vision.htm>

taxpayer has been adopting their existing approach and how they can be helped to improve matters for the future.

- 3.1.2. Moreover, online tools are not accessible to all, so the ‘digitally excluded’ are immediately at a disadvantage. HMRC therefore need to consider how self-employed taxpayers who continue to file their returns on paper may be reached, for example by a direct mailing.

3.2. ***Question 2. Categories of failure and responses - Are the categories and responses at 4.11 above the right categories and the right responses? If not, what should the categories and/or responses be?***

Good records

- 3.2.1. We recommend that, even where taxpayers are found to have adequate records, the check could end with helping them to make further improvements and signposting them to further information which will help fulfil their tax obligations in future.
- 3.2.2. Just because someone has kept good records does not mean that they will complete their tax return correctly, for example, or appreciate all that is required of them.
- 3.2.3. Continuing on the educative theme, HMRC should therefore give the taxpayer the opportunity to ask for further guidance at the time of the check and advise them how they can find out more.

Minor record keeping failures

- 3.2.4. Again, in the case of minor failures, it would be helpful if HMRC do not simply set out a checklist of areas for improvement but also refer them to further sources of advice.
- 3.2.5. Again, this might include educating them in other areas where they might need support to comply with tax obligations and ensuring they claim their entitlements. For example, we understand that HMRC have offered workshops for businesses, so they could be directed to those.¹
- 3.2.6. HMRC should also consider that people may need help in different ways to put matters right (see comments below about understanding the taxpayer’s individual circumstances).

No records or significant record keeping failures

- 3.2.7. No account seems to be taken of why a taxpayer has no records, for example whether they have been lost or destroyed. HMRC’s powers under Schedule 36 FA 2008 are subject to restrictions (see part 4 of that schedule, not referred to in Annex C– ‘relevant legislation’). These restrictions apply equally to pre-return checks as to other compliance checks.

¹ See <http://www.hmrc.gov.uk/bst/>

- 3.2.8. Business Records Checks must be carried out by staff who are fully trained and aware of those areas in which HMRC's powers to inspect are fettered. Moreover, guidance to taxpayers should advise them of those restrictions. We have previously pointed out to HMRC that factsheet CC/FS2 (not referred to in the consultation at all – in our view, it should be) does not explain this to taxpayers. Indeed, as we have said before, it implies a taxpayer should be forced to recreate records no longer in existence¹.
- 3.2.9. Moreover, we recommend that account should be taken of the individual taxpayer's circumstances and the reason for the failure, as to whether the behaviour was an innocent mistake, deliberate, or deliberate and concealed in the same way as other recent penalty regimes. Whilst Section 12B(5) does not specifically discuss how a penalty should be determined, the wording 'not exceeding £3,000' allows broad scope for variation.
- 3.2.10. We do question, however, whether HMRC should determine through guidance how and within what range penalties are determined and we do not agree with the comments in para 4.42 that the actual powers are out of scope of the consultation having been 'consulted on previously'.
- 3.2.11. We appreciate there is no scope to suspend Section 12B(5) penalties, but HMRC have the power to levy a nil penalty. Perhaps HMRC could reinforce the educative message of changing behaviour by, for example, offering the taxpayer the choice of accepting a penalty or attending a course (one of the local workshops referred to above), much in the same way as minor motoring offences are sometimes dealt with; or by issuing a warning letter saying that the taxpayer has breached the record-keeping requirements, explaining how they should keep them in future and setting out that a repeat offence might attract a penalty. This would reinforce the message that what HMRC are trying to do is change behaviour, not penalise indiscriminately those who need help to comply.
- 3.3. ***Question 3. Significant failures – Is the outline proposition at 4.13 above a reasonable basis for drawing up guidelines as to what should constitute significant record keeping failure? And if not:***
- ***Why not? And***
 - ***What alternative basis would be reasonable or drawing up guidelines as to what should constitute significant record keeping failure?***
- 3.3.1. On the one hand, the consultation suggests that identification of significant error 'will be a matter for professional judgement, and not a 'tick box'-style evaluation', but on the other suggests that identification could be by reference to £X of value and N occasions of failure, which do appear to fall into a 'tick box' category.

¹ See CC/FS2, top of page 2, following on from page 1 acknowledging that a 'reasonable excuse' might include loss of 'documents in a fire or flood', HMRC say 'we will still ask you for the information, documents (or replacement documents)...

- 3.3.2. This proposed method would not work, in our view. It does not take account of differences in business circumstances – for example, some could have a large number of small transactions; others a small number of larger transactions.
- 3.3.3. It also does not identify the reason for failures by reference to individual circumstances and behaviour, factors which form a major part of the new penalty regimes following the powers review. We would prefer a method of assessing penalties which does take those factors into account in the same way as Schedule 24 FA 2007 – mistake despite taking reasonable care, failure to take reasonable care, deliberate, and deliberate and concealed. We say more about this below.
- 3.4. ***Question 4. Penalty tariff - What amount of penalty is needed at a minimum to encourage those with significantly poor records to bring their record keeping up to standard, and to deter a potential 'for £X it is worth not having to bother' mentality?***
- 3.4.1. Again, this wrongly assumes that significant failures will always be the result of deliberate behaviour.
- 3.4.2. Penalties should always be proportionate to the failure. If someone has made an innocent error, or has a reasonable excuse, is it proportionate to impose a 'one size fits all' penalty? If the Schedule 24 FA 2007 provisions, and indeed other new aligned penalty regimes introduced in recent years, acknowledge this is not a proportionate response, then so too should a penalty for failure to keep adequate records.
- 3.4.3. If we move on to examine the circumstances in which HMRC believe they 'must impose a penalty where there has been a significant failure', we do not agree that a penalty must always be imposed:
- as a result of a Business Records Check where there is a reasonable excuse or innocent error
 - following an enquiry into a direct tax return which does not show an inaccuracy in a return – ie where a taxpayer has failed to keep adequate records but has nonetheless successfully delivered a correct return. How is it proportionate to levy a penalty in such circumstances? The taxpayer should be helped to improve their records for the future
 - following an enquiry into a direct tax return which has shown an inaccuracy but the penalty has been suspended under Schedule 24 FA2007 provisions. After all, the purpose of suspension is to ensure that systems are put in place to rectify the position in future and if the taxpayer fails to meet those requirements, the suspended penalty is re-imposed. This should be significant deterrent to the taxpayer repeating their previous behaviour without imposing a record-keeping penalty at the same time
 - following an enquiry into a direct tax return which has shown an inaccuracy, even where the penalty is not capable of suspension. This creates 'double jeopardy' for the taxpayer which seems contrary to the intention of the Schedule 24 FA 2007 provisions.

- 3.4.4. We therefore strongly recommend that HMRC reconsider their stance set out in para 4.25 as we believe a nil penalty is appropriate in the above situations.
- 3.5. ***Question 5. Penalty tariff - Should the penalty tariff for significant record keeping failures be the same for all? If not, on what criteria might a workable penalty differential [within the statutory maximum of £3,000] be based?***
- 3.5.1. No, individual circumstances, reasonable excuse and the taxpayer's behaviour should be taken into account. See comments above.
- 3.6. ***Question 6. How can the interaction between the penalties for the very separate offences of failure to maintain statutory records, and making an inaccurate return best be managed and articulated?***
- 3.6.1. See our answer to question 4 above. Penalties should be proportionate to the taxpayer's failure. We do not see that there is justification for levying two penalties in relation to essentially the same failure, for example where a taxpayer's failure to keep adequate records has resulted in errors in a tax return and thus given rise to a penalty under Schedule 24 FA 2007.
- 3.7. ***Question 7. Leverage - Does this seem a good way to encourage the desired change in behaviour, and if not why not?***
- 3.7.1. The suggestion of contacting taxpayers in high-risk groups and reinforcing their record-keeping obligations is in many ways to be supported. We are concerned, however, that the wording of para 4.28ff suggests the contact will be rather more a 'threat' of a check and a penalty, rather than focusing on education.
- 3.7.2. Instead, the latter should be the object of the exercise – for example, highlighting to those taxpayers common errors and suggesting they check their records generally and in those areas of risk in particular. It should also point them to sources of help and advice if they need it.
- 3.8. ***Question 8. Leverage - Are there any other or better ways to encourage the desired change in behaviour?***
- 3.8.1. We strongly recommend that the communications from HMRC should be such as to encourage compliance and provide help and support, not threatening penalties for failure. Whilst the public naturally wish to see HMRC taking action against those committing fraud, increasing 'warnings' from the Department about targeting cheats and so forth also serves to engender fear into those willing to comply with their obligations but in need of assistance to do so. They are therefore deterred from contacting HMRC for the help they need.

3.9. ***Question 9. Time to adjust - What will constitute a reasonable period of time to allow those whose record keeping is sub-standard to make the necessary changes to their record keeping?***

- 3.9.1. We think that a full tax year should be allowed before introducing this new policy, in order to increase awareness and allow taxpayers to get onto a correct footing for the future. However, HMRC appear to have already decided to go ahead later in 2011¹, calling into question whether this is a truly open consultation.
- 3.9.2. The consultation states at para 4.35 that HMRC staff involved in checks will have undergone 'appropriate training' before commencement of the project. Such training needs to include awareness of issues specific to the type of business being targeted with the checks.
- 3.9.3. We also strongly recommend that training must include awareness of individual circumstances, particularly with a view to meeting HMRC equality duties (we comment below on the lack of an Equality Impact Assessment accompanying the consultation document).
- 3.9.4. There are, for example, people with disabilities who work on a self-employed basis – this may include learning disabilities and mental health problems (where the flexibility of self-employment can suit fluctuating capacity much better than employment) which could particularly impact on a person's ability to keep adequate, up-to-date records at all times.
- 3.9.5. Those in charge of designing the checks should therefore liaise with HMRC's Individuals Customer Directorate which is working on mental health awareness training and other disability awareness issues.
- 3.10. ***Question 10. Time to adjust – Would it be useful to begin BRCs on this 'test and learn' basis?***
- 3.10.1. Yes. The learning phase must seek to identify how HMRC staff perform in the trials, for example in identifying not only areas which might lead to a loss of tax but also which may result in taxpayers not claiming all of their entitlements.
- 3.10.2. Whilst no mention is made in the consultation about tax credits, we also recommend that HMRC work closely with tax credits colleagues so that the checks enable HMRC staff to alert taxpayers where they might be missing out on tax credits entitlements. (We are aware, for example, that HMRC have been using tax information to adjust tax credits claimants' awards so the reverse should apply.)

¹ See press release dated 21 February 2011

<http://nds.coi.gov.uk/content/detail.aspx?ReleaseID=418174&NewsAreaID=2&HUserID=895,777,894,854,779,870,710,705,765,674,677,767,684,762,718,674,708,683,706,718,674&ClientID=-1>

3.10.3. This initial learning phase could also be used to identify the success to date of HMRC's communications with taxpayers on record-keeping requirements. Those subject to initial checks could be surveyed to ascertain levels of awareness of the factsheet, online guidance and helpline support HMRC offer in terms of record-keeping. If significant numbers answer in the negative or show limited awareness, this will inform HMRC's approach to further checks, ie helping them to understand whether most neglect of record-keeping is deliberate or is caused by ignorance and misunderstanding of the rules.

3.11. ***Question 11. Publicity and awareness - How might HMRC best work with agents in bringing details of these changes to their clients?***

3.11.1. Not answered.

3.12. ***Question 12. Publicity and awareness - How might HMRC best bring details of these changes to the wider audience, especially unrepresented SMEs?***

3.12.1. HMRC should not only work with paid agents in promoting awareness of the new checks, but also voluntary sector groups who might be able to assist in disseminating information. For example, the mental health charity MIND offers guidance on setting up in self-employment¹. HMRC should aim to identify where such information is made available and how it can be used to spread the message.

3.12.2. It would also be helpful to send details direct to all SMEs, but particularly anyone who is self-employed but who did not include any agent details on their last submitted tax return; plus new self-employed registrations from 6 April 2010 where a return has not yet been filed.

3.13. ***Question 13. Other issues - Are there issues other than those referred to above that ought to be taken into account, and if so, what are they?***

3.13.1. We reiterate and expand on various comments following on from the above.

Rights

3.13.2. We have previously expressed concerns that factsheets omit vital information on taxpayer rights, for example the Part 4 limitations on Schedule 36 FA 2008 powers.

3.13.3. All correspondence and guidance associated with the proposed checks must be consulted on in full, as we would like to be certain that these are phrased in the right terms (educative not punitive) and that people will be fully advised of their rights – for example, in terms of appeals against what are and what are not business records and any penalties imposed.

¹ See http://www.mind.org.uk/help/social_factors/starting_your_own_business

Scope of the checks

- 3.13.4. The notice of commencement of a check will need to be very clear that it is a pre-return check for following year. HMRC staff should not, as a matter of course, go ‘fishing’ into earlier years which are closed. In the case of new business registrations, this should be self-evident; but not in terms of existing businesses. Unless serious irregularities are identified, HMRC do not have power to investigate earlier ‘closed’ periods (see para 21, Schedule 36 FA 2008).

Taxpayer ability and circumstances

- 3.13.5. The consultation document suggests that keeping adequate records is more about ‘diligence’ (para 4.6) than ‘lack of technical ability or neatness’ (para 4.3). Again, whether or not a taxpayer has been diligent must be viewed in the context of their individual abilities and circumstances.
- 3.13.6. In disability terms, someone with dyslexia, for example, might be seeking to be diligent but have inverted some figures when compiling a spreadsheet.
- 3.13.7. In terms of having a reasonable excuse for a failure, someone may have been hitherto keeping excellent records, then have had a change of personal circumstances which has impacted on their ability to do so (for example the death or ill-health of a close relative, personal health problems etc). The usual account must therefore be taken of such considerations.

Tax credits and HMRC-administered benefits

- 3.13.8. As mentioned under question 10 above, the process of Business Records Checks should also include general education of HMRC ‘products’, for example considering interaction with tax credits. HMRC needs to reinforce the message that keeping good records also allows you to make all claims to which you might be entitled.

3.14. ***Question 14. Impact assessment - Do you have any comments on the assessment of compliance costs?***

- 3.14.1. Given the disability issues referred to above, we believe a full draft Equality Impact Assessment should have been provided with this consultation or, in any event, one should be produced before the change in practice is implemented. Ideally, these should be prepared in consultation with interested stakeholders such as ourselves.
- 3.14.2. The impact assessment as it stands does not appear to take into account the impact of the changes on voluntary sector organisations, to which those taxpayers who cannot afford professional advice are likely to turn.

LITRG

28 February 2011