

HMRC Review of Powers  
Compliance Checks  
Room 1/72  
100 Parliament Street  
LONDON  
SW1A 2BQ

5 March 2008

Our ref: CT12/TAX/TC

Dear Sirs

**A New Approach to Compliance Checks  
Consultative Document and Draft Legislation**

PricewaterhouseCoopers (PwC) is grateful for the opportunity to comment on the new Consultation Document issued on 10 January 2008. We remain fully committed to being involved in all the consultations that may be issued as part of Modernising Powers process. We found it very useful to meet on 28 February to discuss the consultative documents.

Before we make any detailed comments on the matters covered in the latest Consultation Document and in the Draft Legislation, there are some points of general application. These points do not only apply to Compliance Checks and they have been made elsewhere, but in the context of Compliance Checks we believe the points are well worth repeating..

The draft legislation (with its accompanying Consultations) issued by HMRC on 10 January is both wide-ranging and far-reaching. The sheer volume of intended changes concerns us greatly. At an operational level HMRC needs to adopt a 'business as usual' delivery but there has been massive change in recent years, starting with the IR/HM C&E merger which does not yet seem fully embedded. HMRC faces challenge with budgetary cuts, IT systems that do not work in harmony, and continued pressure on staff morale. Yet at the same time HMRC is committing itself to

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fundamental changes across its whole compliance arena. The success of these changes depends on delivery; the delivery in turn depends on HMRC's people. We fully understand that the changes themselves will help to drive a 'one HMRC' culture, but that does not make the task of delivering them and embedding them any the easier.

HMRC has a business that is populated with individuals from very differing backgrounds with very differing experiences, used to different working methods and who may have applied themselves differently over a long period of time. The individuals need to embrace the new environment that all these changes will rightly create. There is little reference within these three Consultations about how HMRC will educate, support and apply consistency across its business.

There is also the issue for HMRC of how it publicises (and educates) the new regimes to the taxpaying public and their advisers? We believe that it is essential for HMRC to publicise how it is going to address its internal training for all these fundamental changes and if appropriate, involve the profession in assisting and supporting this massive task.

Our comments on the Compliance Checks proposals are both substantive and detailed. Our substantive comments as follows;

- 1 HMRC is to be congratulated on how the all the matters covered by this Consultative Document have been presented. However, there are some radical changes here and we feel the Document could have been much improved by the inclusion of a summary of key changes together with statutory cross-references.
- 2 Even perhaps more than in relation to the Penalties changes, the Codes of Conduct/Practice relating to the matters covered by 'Compliance Checks' will be vital for safeguarding the interests of the taxpayer. Because the Codes have to cover such a wide range of taxpayers there is a danger either that they will become meaningless, and/or they will apply to only one class of taxpayer (that probably being the lowest common denominator). This must be avoided at all costs.
- 3 We support that introduction of 'one size fits all' ('taxes') systems wherever that is possible.

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- 4 We support the move to an inspection based approach to the checking of Self Assessment Returns. This is consistent with the view that PwC has always taken, that a necessary corollary of a process now/check later system is that the authority has the right of access to and inspection of the records on which a self-assessment was made.
- 5 We believe that preservation of the enquiry window is essential and that it is also a necessary part of any self-assessment system. Similarly, certainty that an enquiry has ended is essential and the circumstances whereby HMRC may reopen a closed enquiry should be extremely limited.
- 6 One issue that is not addressed is the frustration when a new issue is raised well into an existing enquiry. We believe there ought to be a point in time beyond which what would be a new enquiry into an already under-enquiry return could not be made. (Such a limitation would of course not apply if the new enquiry related to an offence and would not preclude the existing enquiry being developed.)
- 7 We fully support a risk-based approach to compliance checks but we accept the need for random checks. We believe that it is essential that a taxpayer's risk assessment should be shared with the taxpayer or, if the taxpayer has been selected for audit randomly, the taxpayer should be told. If it were not for the obvious difficulties surrounding a statutory definition, we would have asked for sharing of the risk assessment to be statutory, but we accept that is almost impossible. We therefore expect that HMRC's guidance will make it mandatory for the risk assessment to be shared with the taxpayer.
- 8 We found the summary of the proposals for harmonised time-checks most helpful and the proposals themselves very sensible. We believe that it is right to recognise that there should be a lesser time limit for a lesser offence and that time limits where there is no offence should be less than the time limit where there is an offence. However, we were unclear as to why the NIC time limit for deliberate understatement was only 6 years (all the others in this category being 20).
- 9 PwC remains fundamentally opposed to the proposition that HMRC should be entitled to check an ITSA return or a CTSA return prior to the filing of that return. If HMRC was to take a pre-return

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checking power that could only be exercised by agreement with the taxpayer, such a power might be acceptable.

- 10 For its part, HMRC is clearly determined to have the power to examine records pre-return. HMRC argues its case in paragraph 5.25. If HMRC does inspect pre-return, it must be with the objective of assessing records in principle and informing risk procedures, and not questioning how things are treated in books and in returns that have not yet been properly completed and/or where the taxpayer has not made a filing decision. Those safeguards need to be built in.
- 11 There is also the question of whether or not checking pre-return has an impact on any inaccuracies in a return submitted after an examination pre-return and PwC questions if such matters have been fully thought through. The ability to check by inspection is fundamentally different as compared with the ability to ask questions following a return being filed. Checking and inspection carries with it the ability to look at everything and the assumption at the end of the check is that everything is fine apart from those areas the checker has discovered and brought to the taxpayer's attention. If a taxpayer files after a pre-audit check and there is an inaccuracy in the filing, why is it not open to the taxpayer to say, 'you checked everything; you didn't tell me that 'x' was wrong; I thought everything was OK because you had checked; why should I now be penalised?'
- 12 The other side of the coin is: what happens if HMRC finds an error during a pre-return check? Even if that error is deliberate, no return has been filed. Does HMRC accept there can be no penalty in that situation?
- 13 PwC is grateful for the confirmation given during the meeting on 28 February that the reference to 'undisclosed avoidance scheme' (paragraph 6.7 final bullet) was a reference to the Tax Avoidance Disclosure scheme.
- 14 As regards paragraph 6.21, PwC finds it difficult to envisage how a closed enquiry window might be opened unless there had been an offence. If there was an offence PwC can see no reason why information powers should not be used. The word '*checking*' does not appear to restrict the use of the information power in any way.

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- 15 PwC fully supports the use of informal review processes. PwC would encourage HMRC to think in terms that business and the profession has a valuable role to play in such processes.
- 16 The proposals for record keeping in Chapter 4 seem reasonable but it would be good to have it made clear that HMRC will not impose additional record keeping requirements where the taxpayer is able to meet their obligations using existing records.
- 17 Similarly, the point about administrative burdens at paragraph 4.18 is fairly made; a variant on this might be that the business feels that once it has sent a return into HMRC, which has been accepted, then it does not have to retain records. The time limits at paragraph 4.22 show the anomalies with this and it would seem logical to allow the taxpayer to get some sort of early clearance certificate to enable them to dispense with retained records. Whilst the biggest cost in record keeping must surely be the creation of them, retention is not a negligible cost, even in these days of electronic filing. We encourage HMRC to review this matter further.
- 18 The changes to information powers cause concern at both a macro and micro level. We applaud the attempt to produce a one-size fits all power. We accept the need for a supplementary power in addition to the checking power except that the supplementary power should not be used because the checking power has been used inadequately (HMRC poorly carried out an inspection). We would expect the checking power to mirror the checking powers that presently exist and the supplementary power to broadly reflect S20TMA 1970. We would expect all the present safeguards to remain, not least in view of the body of case-law that has built up around the powers, most of which case-law is concerned with the inappropriate use of a power. We think these aims are reasonable and we are not convinced they have been achieved.
- 19 Including non-SA taxpayers in the system is acceptable; as for non-business tax records, there certainly needs to be a safeguard for the taxpayer built in that HMRC must demonstrate that the request is reasonable and, in addition, relevant to a matter under consideration. Probably that is not something that needs to be authorised by a Commissioner in advance, but the taxpayer would in principle be able to resist the demand for non-business records and require, at a hearing, that HMRC is able to show that its request is reasonable and relevant.

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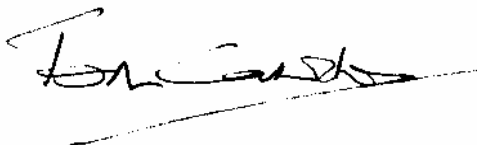
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- 20 It is accepted that HMRC needs a power to obtain information from third parties. The key here is that the power needs to be exercised only where it is necessary and then in a proportionate way. It would be all too easy for HMRC to request vast volumes of data with little prospect of being able to use it sensibly. This needs further study and something of a code of conduct drawing up with industries such as banking and insurance particularly in mind. Codes of Conduct relating to the use of the powers will be a vital element in the safeguards mechanism.
- 21 One matter that is not covered either within the definitions to be found in the draft legislation or in the explanatory note is the meaning of the word '*information*' in the context of '*information ..... required ..... for the purpose of checking the taxpayer's tax position*'. (Schedule 2, paragraph 1) We understand that HMRC has been advised by parliamentary counsel that the word means 'informing of fact'.
- 22 Appendix 1 contains further comments on the draft legislation and Appendix 2 contains more detailed comments on the Consultative Document.

Finally we encourage HMRC to make it clear to taxpayers that they should not be afraid to seek closure of an enquiry; and they should not be afraid to complain if there are genuine concerns about how an enquiry has been handled. All too often taxpayers are prepared to 'sit and take it' because of a concern that complaining about what is happening will count against them now or in the future.

Yours faithfully



John Whiting and Tom Cawdron  
Partners

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## Appendix 1 - PwC Comments on Draft Legislation

### Schedule 2 – Information and Inspection Powers

HMRC's attempts bring together the existing powers found in S19 TMA 1970, S20 et seq TMA 1970, Paragraph 27 Schedule 18 FA 1998, elements of Schedule 11 VATA 1994 and Regulation 97 result in far reaching changes to these primary information powers. PwC notes that the proposed new powers are in essence a combining of these existing production and inspection powers. PwC has a number of comments on the draft legislation, as follows:

Paragraph	Comments
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#### Legislation

- |      |  |
|------|--|
| 1    | <p>The key words here (and indeed throughout the legislation) are (a) 'information' and (b) 'documents'. The word 'document' is defined in paragraph 44. We suggest that the following concepts need to be enshrined in the legislation:</p> <ul style="list-style-type: none"><li>• Information equates with fact and this concept needs to be defined; information cannot be opinion (and if it cannot be opinion is cannot be advice);</li><li>• Document needs to be limited to a document containing <i>information</i> 'reasonably required ....' etc; and</li><li>• Document needs to be defined as including part of a document, thereby giving statutory recognition to the concept of redaction.</li></ul> |
| 3(5) | <p>It is not understood why a 'precursor' notice is not sent to the third party, whatever the circumstances. The third party should always have the right to</p>   |

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make representations for the Commissioner to consider.

- 4(2)(b) The reasonable grounds ought always to be offence related. It ought to be the case that informing the taxpayer should only be disapplied in cases where there is the potential for the most serious level of penalties to be applied to any unpaid tax.
- 8(2) In what circumstances does HMRC envisage that it will be unacceptable to produce a copy of a document (electronic or otherwise)?
- 11, 29(3)(b) and 31 The ability to remove documents combined with the ability to inspect without notice represents a very serious step and is of great concern to PwC. In the final analysis, it is not unreasonable to describe it being akin to a search and seizure power. That is unacceptable. HMRC's now has access to the PACE search and seizure powers and the taxpayer's protection is to be found in the PACE Codes of Practice. There appear to be few safeguards in relation to the proposed legislation that (however the legislation is operated) in theory gives HMRC the power to turn up at a business premises unannounced and remove documents. (We appreciate that legislation that gives HMRC the ability to remove documents already exists in relation to, for example, Regulation 97. That is very specific legislation. What is being discussed here is a far-reaching one-size fits all power.)

Even if this power is enacted, in PwC's view paragraph 11(2) ought to read:

- 'Where a document is to be removed from the place where it is produced for inspection, the officer of Revenue and Customs shall, prior to its removal, provide –
- (a) a receipt of the document, and
  - (b) a copy of the document

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and an officer of Revenue and Customs shall comply with such a request without charge'

13 The agreement ought only to be given in cases where there is an offence or a potential offence and the legislation should be drafted accordingly.

17 It is assumed that the insertion of the word 'legal' is not intended to limit the protection in any way and that HMRC accepts that the protection applies equally to litigation privilege and to legal advice privilege.

17-21 (See Paragraphs 6.30 and 6.34 below) PwC fully supports the retention of these paragraphs.

17-21 PwC can see no reason why the legislation should not also contain the following (for example as a new paragraph 20A):

'A notice (as defined in paragraph 7(2)) does not require the recipient of either a taxpayer notice or a third party notice to provide information or documents that would not have to be provided by a lawyer, auditor or tax adviser by reason of the provisions of paragraphs 17, 18 or 19 above.'

22(2) and 23(2) The reasons for this limitation are not understood, especially given that the meaning of taxpayer records is so wide-ranging.

24 The reasons for this power and the circumstances in which it might be appropriate are not immediately clear to us.

23(1) and 25 We do not agree that the grounds for appeal should be artificially restricted in the manner proposed.

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- 25(4) We presume that it is accepted that there remains the potential for judicial review of the Tribunal's decision.
- 29(3)(b) Authorisation should only be permitted where there is an offence or a suspected offence and this aspect should be legislated
- 31(2) To be amended as per 11(2) above.
- 35(1)(a) The word 'obstructs' is nowhere defined in the draft legislation. What is HMRC's intended interpretation of this word?
- 42 How is it intended that a penalty under this provision will interact with other penalties that could be due in relation to the tax due? Is it clear that, taking all the various penalty provisions into account, in no circumstances could a taxpayer be charged penalties that in total amount to more than 100% of the tax due?
- 44 What is the intended meaning of the words 'investigation' and 'enquiry'?
- 51 We note that these proposed powers are confined to four of the five main taxes. We would support the extension of those powers to all taxes, duties and the like with the repeal of any particular powers relating to all those other taxes and duties. We would support HMRC moving to this simplified approach to powers at the time all these new powers are introduced.

**Commentary**

- After 6.8 PwC appreciates the difficulty of combining S19, S20 and paragraph 27. However, PwC regards it as a retrograde step that there will be no written

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summary prepared of the reasons for issuing a notice. Similarly, PwC is not convinced that the reason given for there being no opportunity to comply informally is a sufficient safeguard given the removal of the 'precursor letter' that is presently required by S20B(1) TMA. As a minimum, there should be an HMRC requirement that a file note is prepared in every case setting out the reason for the issue of a notice. If an appeal or dispute occurred subsequently, HMRC would be expected to produce the file note to the Tribunal (or any party who might be involved in resolving the dispute)

- 6.11 In PwC's view, the third party must always have the right to make representations.
- 6.14 PwC has no objections to this proposal.
- 6.22 As will have been noted from the above, PwC does consider that further safeguards are needed.
- 6.25 Subject to our above comments, PwC welcomes this approach.
- 6.30 and 6.34 PwC believes that restating S20B(8) and S20B(9) to (11) is essential unless it is clear from the legislation that the words 'information' and 'advice' are mutually exclusive and that the word 'information' is intended to be synonymous with 'fact'.
- 6.46 PwC understands HMRC's reasons for making visits without prior arrangement but nonetheless views such visits (and therefore the legislation) with great concern. HMRC's guidance and Code of Practice governing such visits will be vital and will be studied with great interest. These need to be issued in draft, for discussion before they become final modus operandi.

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## Appendix 2 - PwC Comments on aspects of the Consultation Document

We have a number of comments on the Consultation Document at a detailed level, as set out below:

- 3.17 There is a reference here to access to records that are overseas. Often HMRC may request material that is held abroad in a situation where the potential for UK taxation is in dispute. What is HMRC's proposed solution to a situation where the taxpayer does not believe there is any UK liability (and therefore does not need to take note of any UK legislation relating to record-keeping or making information available)?
- 3.26 It will be essential for HMRC guidance to be explicit as to what is envisaged as being undertaken at such a visit, particularly to a private residence with business premises included? HMRC needs to take into account the impact of such a visit on family, neighbours and customers of the business. Guidance and training will be vital here. PwC would expect that, with time, HMRC will develop an 'audit manual' of the type seen in other jurisdictions.
- 4.16 PwC does have concerns about HMRC's approach as regards records, defining records, and record-keeping. Experience shows HMRC to sometime be a little vague and unhelpful in this area. Indeed, when asked, Inspectors are not sufficiently able to advise about what type of records to keep other than giving very generic answers. Given the potential for penalties for record-keeping errors, PwC believes clear guidance to taxpayers is essential in this area.
- 4.28 The format of and accessibility to records will be a key issue given increased use of IT and HMRC's increased information requests which require interrogation of IT systems. Accordingly there needs to be clear guidance and understanding of what HMRC may want to ask for across the entire taxpayer base.

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5.16 HMRC's reasons for access to non-business records need to be clear and need to show why access is necessary. There also needs to be recognition that non-business records may be jointly held. How does HMRC propose addressing the right to privacy for the other person not subject to the enquiry?

5.24 Visiting business premises and reviewing records for ITSA and CTSA purposes will require clear guidelines in what can and cannot be undertaken. The taxpayer will need to know what is happening and why. In other jurisdictions, Revenue activity involves audits at business premises and is part of accepted culture. In the UK, although taxpayers are well used to VAT/PAYE audits they are not in the majority of cases used to direct tax audits. Nor are tax officials. Education and clarity will be required on all sides.

Additionally the way investigations have been worked to date does not fit easily with the idea of undertaking record reviews in situ. HMRC has tended to take a long time to review records; reviews can be unfocused, consisting of individuals trawling through masses of paperwork, rather than focused reviews/audits. It will be essential for all sides to understand what HMRC wants to do on an in situ review situation, which should be focused and directed and not a fishing expedition across thousands of records. Key risks need to be identified before the review; the taxpayer needs to be aware of the risk areas; and HMRC's review needs to be focused on those risk areas. If there are some locations not for whatever reason suited to an on site review this point needs to be recognised by HMRC and should not be seen as obstructive or deliberate on the part of taxpayer.

5.25/6 If HMRC accepts the principle set out at the start of paragraph 5.26 then some of the reasons for the power to audit pre-return fall away and such a power clearly creates a risk of duplication of audit (and therefore wasted resource) on all sides.

5.31 In PwC's view comparing VAT visits with direct tax enquiries is not a valid comparison. The basis for VAT visits is not comparable to a typical direct tax enquiry and unless some alterations are made to the direct tax enquiries approach and aims the two will

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never will be comparable. That is not the same as saying that HMRC needs to speed up the time it takes to deal with some direct tax enquiries; speeding up is something that PwC fully supports.

- 5.34 HMRC will need to explain why undertaking a visit and record review on site is actually going to assist its enquiry; what the perceived risk areas are; what HMRC wants to do and that it can do in a reasonable time. The business should be able to lodge objections and where commercial sensitivity and customer impact are potential issues, HMRC needs to give due consideration to them. HMRC needs to recognise and take account of the fact that its actions do have to ability to cause financial damage.
- 5.36 Has HMRC fully thought through all the Data Protection Act issues? Unless a formal notice has been served, the DPA may be an area of difficulty.
- 5.39 We assume that HMRC's guidance notes will in due course define the words 'potentially relevant'.
- 5.43 Clearly the idea of an officer reviewing the request is reasonable. PwC suggests that the issues that have arisen in case law over time about s20 notices should be enshrined in the process and if appropriate the ability to make representations in writing during that process be offered. It would be useful to be able to see that any review process was reasonable and not biased towards the enquiring officer.
- 5.50 HMRC has not fully explained why there is a need to remove precursor notices or why and how removal will improve the system. Approaches to third parties can be significant in their impact and need careful and sensitive handling. There is no review of or recommendation that agents could be utilised in this sensitive area by making the approach in first instance after HMRC have made clear what it wants and why it needs the information from a third party (obviously excepting the more serious cases).

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- 5.50 How will HMRC be held to account if its actions involving third party enquiries damages the taxpayer's business?
- 5.51/2 Given that each entity has its own board and legal independence PwC sees no reason why this HMRC idea should be considered.
- A6 HMRC is encouraged to be open in its correspondence when challenging an issue, allowing the taxpayer to respond directly and quickly and removing any ambiguity.
- A11 As soon as HMRC has concerns it should challenge openly and allow the taxpayer to respond and supply answers/information without recourse to notices. If HMRC issues notices without allowing the taxpayer an opportunity to respond, that should not reflect on the taxpayer's cooperation in the enquiry.
- A13 Examples of the issues would be most helpful.
- A16 There needs to be a formal record of the visit including what has been seen and done, with relevant notes and copies of documents taken/copied by HMRC. The notes should be shared with the taxpayer as a matter of course and the taxpayer should have the opportunity to challenge or respond to HMRC's notes.
- A21 The aim to be open in writing on risks, errors etc identified is applauded. HMRC needs to be willing to be expansive in its correspondence referring to appropriate documents and reasoning behind its determinations.
- A22 Will HMRC be elaborating on what is seen as a 'less complex case'?