

THE TAXPAYER STRIKES BACK

First Edition

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LEGAL NOTE

My original intention was to produce a factual piece of work that could clearly be seen to reflect the actual cases with which I have been involved, quoting full details of cases (but not identifying individuals of course). An extract from the legal advice that I have received in relation to the script as originally written is as follows.

“HMRC cannot let somebody say these things without making a stand. Further the Government and especially the Treasury could not allow this to go out unanswered.

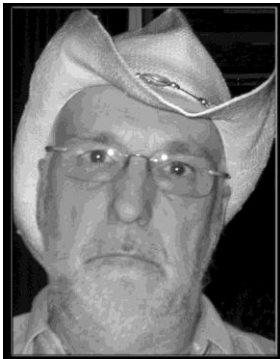
The age old theory is that providing what you are printing or saying is true it doesn't matter. This is of course rubbish. Even if what is, as here written, is [sic] true you have to have the wherewithal to fight. You would be looking at a bill of several £100Ks. Further if the HMRC or HM Govt ask a host to remove it from a site they will do (or at the least not oppose an Application to the Ct to require it to do so). My advice is do not publish this.....”.

I found this significantly upsetting given the concept of democracy in the society in which we live. The section in bold I found particularly untenable given that, in relation to at least some of the cases, I have clear evidence including recordings of conversations, and copies of letters. Whilst I absolutely **do** have the wherewithal for a fight, I lack the substantial resources alluded to, (any offers of support for a more forthright approach?). From other legal cases with which I have been involved, I realise that the potential cost estimates are realistic, and how very quickly legal costs can build up.

Furthermore this book has been written for a specific constructive purpose and I do not want it left languishing on the shelf unread. Instead therefore of publishing the fully factual piece of work I had originally intended I have conducted something of a rewrite and pitched the issues somewhat differently. Instead of referring to

specific cases I have decided to use examples of how situations might have been. I leave it to the reader, with such knowledge of the Taxation system as he has, to consider whether those examples are likely to reflect the reality of life as he might expect to see it.

WHY USE MARTYN ARTHUR TO ASSIST WITH HMRC INVESTIGATIONS?



Martyn has over forty years experience of dealing with tax, accountancy and business issues from every conceivable angle. He joined the Inland Revenue (HMRC) on leaving school in 1968 and worked there and in the wider civil service for some seventeen years. Latterly in the National Assembly for Wales, he was extensively involved in drafting legislation that was laid before Parliament. This experience enables him well to be able to interpret statute and case law. His time in the civil service has resulted in a thorough understanding of the nature and outlook of HMRC and the staff that work within it.

On leaving the Civil Service Martyn developed a thriving accountancy practice. Increasingly, because of his ability and past experience, the more difficult cases relating to disputes with HMRC were referred to him by other accountancy practices. His accountancy practice was sold in house to his staff when he became the principle deliverer of business mentoring and action planning for South Glamorgan Training and Enterprise Council.

Martyn “retired” in his early fifties and focused on lecturing in accountancy and business subjects. He soon became bored however and returned to the cut and thrust of business life some five years ago. Since then he has specialised in the resolution of HMRC Tax Investigations and associated disputes. Miles Waterman Accountants, Bexley Heath, have commented:

"In all my years dealing with HMRC enquiries I have never come across anyone like Martyn, he is truly unique. His tactics? You just wouldn't dare, but Martyn does dare, and wins!"

Additionally he offers talks and seminars on the topic of Tax Investigations. These are delivered both through registered Continuous Professional Development (CPD) seminar providers, and directly. Both forms of delivery may contribute to professional verifiable CPD requirements. The ACCA guidance as it relates to the direct delivery in respect of that organisation is reproduced at Appendix 1.

Presentations may be concise one hour ones, a half day or a full day. The presentations are not of the Power Point and "questions at the end" type. Direct interaction with, and the participation of, the delegates is invited and welcome from the outset. Delegates are encouraged to participate with both hypothetical questions and real life case issues.

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1. OVERVIEW: THE SYSTEM IN CONTEXT

The Tax Inspector

The start is probably as good a point as any to consider just who or what exactly is this entity, the Tax Inspector, who is capable of striking fear into the hearts of otherwise brave people? **Are Tax Inspectors demigods, human incarnations of the Norse God Thor, able to strike us down at whim with a bolt of lightning?** I think not! Fortunately the general understanding of the authority / power situation as regards the Tax Inspector, as frequently expressed to me by taxpayers and accountants alike, is a complete misconception which I am pleased to be able to correct here.

1. First and foremost Tax Inspectors are salaried civil servants, administrators occupying junior management positions within Her Majesty's Revenue and Customs (HMRC). The term "junior management" is not intended to be in any way derogatory. The civil service, of which HMRC is a part, operates on the basis of a tiered management structure, in respect of which the grade of Tax Inspector is very much at the lower end.
2. The Tax Inspector's job is simply to assist with the general administration of the UK Tax System, nothing more.
3. Tax Inspectors specifically do not have any personal powers, by comparison with, say a Police Officer who has the power of arrest without a warrant and even the power, in appropriate circumstances to take a human life.
4. Tax Inspectors have a certain amount of delegated responsibility to implement certain procedures such as the implementation of penalty procedures.

5. Tax Inspectors do not have ownership of the cases with which they assist in their day to day work. If an alternative administrator takes over the case their importance in relation to it reduces to nothing.
6. HMRC has recently changed the title of the job description to remove the term Inspector. Since then I have heard talk of a loss of status! But what status? HMRC staff, like me, are ordinary rank and file individuals doing nothing more than junior managerial tasks.
7. In the process of undertaking his job, part of the function of the job of a Tax Inspector is to assist in a pragmatic assessment of the facts with a view to arriving at a factual assessment of a situation.

As a slight but relevant digression, within the conduct of a pragmatic assessment I see no scope for the use, by Tax Inspectors, of emotive expressions such as amazement, belief or disbelief, disappointment, surprise and many others that one meets from time to time.

Note, this is not a technical book with specific technical points, and the message being made may not always be readily apparent just from the text. Important points are therefore recorded at appropriate points in bold italicised text, as is the case below. A summary of these, in the order made, is included in Appendix 2.

Tax Inspectors are not demigods, human incarnations of the Norse God Thor able to strike us down at whim with a bolt of lightning. Within the System that is HMRC the Tax Inspector is simply a rank and file individual with no personal power or authority. He is a junior manager whose job it is to assist with the administration of the UK Tax System.

Consider, around the end of July annually, final year university students across the country will have finished their exams and many will become graduates. Some of those graduates may well become Trainee Fast Track Tax Inspectors and, following on from this, in a relatively short period, they will have started to work their own cases under varying degrees of supervision. Yet just a relatively short time before they may have been just ordinary students, maybe propping up the bar of the students union and going to wild end of year parties. They weren't creatures to be dreaded then, so what has changed?

The individuals haven't changed per se; they are still the same people that they were a relatively short time before! What has changed is that they have become employed by HMRC in the position of assisting in the administration of the UK Tax System. Those individuals who will become the subject of their attention, generally accountants and taxpayers, will have neither knowledge of their background nor a detailed understanding of their role in Tax Investigation work.

When considering and discussing "the" Tax Inspector it is essential to be clear that we are not considering in any way the Tax Inspector as a private individual, in his capacity as a human being, going about his private, not work related daily business. We are considering him very specifically within the cohesive whole "System" that is HMRC, and in the context of the manner in which he undertakes his work within that System. We will consider the way Tax Inspectors undertake their duties within the System, and how the System overall influences their performance approach and attitude.

As a starting point, when considering and discussing "the" Tax Inspector, we are not considering in any way the Tax Inspector as a private individual, in his capacity as a human being, going about his private daily business. We are considering him very specifically within the cohesive whole "System" that is HMRC, and in the context of the manner in which he undertakes his work within that System.

I do not have any formal psychological qualifications and as such it would be inappropriate for me to endeavour to introduce amateur psychology. I am however competent to speak about matters associated with education generally. The book *Lord of the Flies*, by William Golding, (ISBN 0 571 06366 7) whilst fictional, is recognised as a classic and is extremely well acclaimed. Whilst covering a lot of other ground it provides a fascinating insight into the interactions, of human beings when in a cohesive system, and how those individuals interact with and become immersed into that system. It could maybe be an excellent piece of further reading should you be so inclined.

Authority and Power

So exactly what authority and power do these Tax Inspectors have? Regardless that they do not have demigod status as discussed at the outset, ostensibly they may appear daunting to the layperson. They almost inevitably attend meeting in pairs at a minimum, are immaculately dressed, and are polite but firm. They are “well trained” in the theory of things, and able to quote readily and copiously from regulations and legislation. Yet we may find it difficult to understand their approach and perspective to their work and the subjects thereof, which may frequently differ from ours. Most importantly we may perceive them as having a significant degree of authority and power.

How can an ordinary layperson such as you or I possibly challenge statements, assertions and the like made by such individuals? To understand this we need to further consider the overall System and the functionality of the individuals employed in it.

During the process of administering the UK Tax System the Government Department that is HMRC generally, has a significant degree of power to undertake a wide range of activities, for example conducting raids, covert surveillance and a great deal more. A

consideration of those kinds of activities is outside the subject area of the Tax Investigations into individuals, partnerships and Limited Companies that this book considers.

This book is about the “routine” day to day Tax Investigations that are conducted by office based Tax Inspectors. In this respect HMRC’s powers are not as wide ranging as those involved in the activities mentioned in the previous paragraph. They are largely restricted to procedures for obtaining documents, and the instigation of a narrow band of penalty procedures as set out variously in their Codes of Practice (COP) guidance leaflets 8, 9, 11, 14 and others.

It is important to understand that the power that HMRC does have is vested in the **Government Department** that is HMRC, not the private individuals who are **individual Tax Inspectors**, although there are some minor exceptions to this! In terms of “Tax Inspectors”, they are primarily authorised to conduct negotiations with the object of coming to a reasonable agreement as to the quantity of duties which may have been underpaid, or even overpaid by the taxpayer in a particular set of circumstances. As we will see later the principle governing the agreement is not what the Tax Inspector does or does not believe. It is the situation that is most likely to accurately represent the facts, based on as factual as possible a judgement of the circumstances of the case.

Tax Inspectors also have the discretion when to instigate penalty procedures. Importantly, they are not entitled to the final say in the quantum of any required adjustments, or whether the payment of penalties imposed will be enforced. Taxpayers are entitled to appeal against these and those appeals are the subject of similar types of appeal procedures as are other statutory matters that are disputed.

It is important to be clear that it is not only the enforcement of a penalty that can be disputed (on appeal). Even the simple discretionary decision when to impose a penalty can be disputed! In fact any incident of the use of discretion by a Tax Inspector can be disputed; it is simply that the medium for consideration of the

dispute is different from that of statutory matters, which must go finally to formal appeal. As such, and completely separately to the right of appeal against a penalty itself, a personal complaint can be made against the individual Tax Inspector if it is felt that that discretion has been inappropriately used. If such a complaint is not satisfied within the HMRC System (about which I write later) it can be followed through to the Adjudicator's Office.

In the context of the Tax Investigations that are the subject of this book, HMRC's powers are not wide ranging and are largely restricted to obtaining documents and to the instigation of a narrow band of penalty procedures. It is important to understand that authority is vested in HMRC, not individual Tax Inspectors, who simply have the discretion when to instigate procedures. The proposed quantum of any suggested adjustment and the instigation of penalties can, if considered inappropriate, be the subject of complaint.

General Objections to the Nature of the Conduct of Tax Investigations

It is clear that the tax System has to be administered, and there can be no reasonable objection that, within a Self Assessment regime, there has to be some medium for checking Tax Returns submitted. We will be considering the detail of the various elements of a Tax Investigation later. For now however I just want to try and be as clear as possible exactly what issues I, the numbers of people who have consulted me over the years and accountants and the public generally have with Tax Investigations and the manner in which they are conducted.

So what exactly is it that is so objectionable? I had intended, in this section, to go through some real life situations but, in the light of

legal advice received, I have decided to work through a hypothetical example. It is inevitable that some subjects of Tax Investigations will be completely innocent, and that there may be significant concern about the civil procedures to which they have been subjected. As such I suggest that the hypothetical private individual who is the subject of our hypothetical Tax Investigation be regarded as someone who is completely innocent of any wrong doing.

The Opening of the Tax Investigation

The Opening Letter from HMRC

Completely out of the blue the Taxpayer receives a terse letter accompanied by a detailed explanatory leaflet the **first line** of one of which may start, “**We will investigate any situation where we suspect serious tax fraud. The investigation will be undertaken with or without your voluntary co-operation**”. Enough to put anyone off their early morning tea and toast I think! I dislike expletives generally but, who the hell does the System that is HMRC think it is to make statements like this across the board, to people, some of whom, as in the case of our hypothetical individual, must inevitably be innocent? It is absolutely ridiculous and completely, completely unacceptable! Yet for our innocent taxpayer, this is the start of an ordeal which can last for years.

So from the very outset we have an **innocent** individual who is immediately plunged into in a state of complete despair. He is probably self employed and anyone on this side of the fence will know the stresses of keeping records and the errors that can creep in. “What have I done wrong, why am I being targeted?” are almost inevitable questions, followed by the suspicion or fear that something terrible really has occurred. I will not get into the scenario of general speculation about stress, depression, heart attacks and the like, but the potential consequences for an ordinary individual, of receiving such a communication must surely be self evident.

I can certainly attest, in respect of the first six months of 2009 alone, to circumstances where individuals have been so concerned that they have telephoned me in tears, visited their accountant late at night at home in fear having received such a letter, been diagnosed by their physician as suffering from clinical depression, and lost a substantial volume of weight. Clearly HMRC must be entitled to instigate enquiries, or even Tax Investigations, but the whole opening concept and approach may frequently be unreasonably heavy handed and inappropriate.

Documents issued by HMRC in relation to Tax Investigations into potentially innocent taxpayers may open “we will investigate any situation where we suspect serious tax fraud. The investigation will be undertaken with or without your voluntary co-operation”. Clearly HMRC must be entitled to instigate enquiries, or even Tax Investigations, but the whole opening concept and approach may frequently be considered unreasonably heavy handed and inappropriate.

In relation to the “recent” Notice 160 Compliance Checks coming increasingly into use, HMRC have gone even further in their arrogance! The opening letter now starts with the bland statement “we have reason to believe that under declarations of VAT have occurred, and this may have been the result of dishonesty”! Who the hell do they think they are?

The customer can become completely distraught in a case based on, for example, nothing more than a couple of hour’s covert surveillance and a few assumptions.. I am absolutely furious about it!

Moving on Briefly from the Opening Letter

Moving on from the opening letter the almost inevitable next stage is the need for the taxpayer to consult a professional adviser who in turn may have to answer an array of questions imposed on him by HMRC, and which can extend to several pages. Additionally the taxpayer will be required to assimilate and submit a variety of business documents in the short term. Later on he may be required to submit personal documents not associated with his business. As the latter are not business records copies may not have been retained and he may have to pay various institutions to supply further copies.

The direct cost of the foregoing is something that the taxpayer will have to bear himself. Additional to the direct costs there are also the incidental time and related costs associated with the disruption to business life that the taxpayer will be required to bear. Add in the costs of the professional adviser and even at this early stage those costs may have accrued potentially to at least several hundred and possibly thousands of pounds. Yet regardless the innocence of the taxpayer in this hypothetical example, **none of that money will ever be refunded to him!**

All of this takes us only to the end of the opening stage and brings to my mind Prime Minister Winston Churchill's famous statement during World War Two (taken here in a slightly different context)? "This is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning"! To the reader, remember please that the taxpayer, in this hypothetical example, is one who is completely innocent of any wrongdoing!

The Taxpayer, regardless his innocence, will almost inevitably incur substantial cost from the very start of the Tax Investigation, none of which will be repaid to him, regardless his innocence or guilt.

The Opening Meeting

The examples I had intended to refer to here have been removed consequent upon legal advice received. Descriptions relayed to me by taxpayers who have been involved in such meetings range from (their words), “extremely stressful”, through “horrendous” to “I was physically ill after the meeting”.

I have made numbers of attempts to address the question of the first meetings in a manner that adequately described them, whilst at the same time avoiding making the kinds of statements that legal advice has warned about. All of my attempts have met with failure and it must be left to the reader to ruminate whether it is a lack of writing skill on my part that has brought this about or whether some other element, such as the nature of the system, is the cause.

This book, the first episode in a series of books, has been marketed almost exclusively to individuals and organisations that are likely to have firsthand experience of Tax Investigations. As such I am able to say with a very significant degree of certainty, that there is no real need, in any event, for me to exemplify these meetings.

Thinking on to Episode 2, which will be more widely marketed, I would be extremely grateful to receive (anonymously if preferred) a brief account about the conduct of any meetings in which the reader has been involved, regardless whether they reflect a negative or a positive account. Subject to legal advice I will incorporate them into Episode 2 which I hope will follow shortly, although, for the avoidance of possible doubt, there are no royalties on offer for any such contributions. Please just take a few minutes to write about them and email them to me, martyn@martynarthur.com or send by conventional mail to Martyn F, Arthur , C/O Ogmores By Sea Post Office, Main Rd CF32 0PW.

This now concludes the introduction to the opening stages of the Tax Investigation. What may follow next in a Tax Investigation is so

potentially diverse that it does not lend itself to any further brief references and is discussed in much of the remainder of the book.

Examples of meetings that I had originally intended to use have been removed consequent upon legal advice received. I will be grateful to receive both positive and negative tales of Tax Investigation experiences that readers have encountered anonymously if preferred). Please email them to me, martyn@martynarthur.com or send by conventional mail to Martyn F, Arthur, C/O Ogmores By Sea Post Office, Main Rd CF32 0PW.

2. GENERAL POINTS

The Term Taxpayer

For whatever reason, best known to HMRC, the “taxpayer” as I have known him for some forty years is now referred to by HMRC variously as the “Customer”, or “Client”. One reason suggested during a general conversation with a Tax Inspector is that the public wish to see HMRC perform on a more personal basis. If this is indeed the case and HMRC genuinely believes that the change of title will have the desired effect then they are so unbelievably wide of the mark as to be completely off the planet! For the moment, for me, the descriptions “Customer” and “Client” are completely inappropriate. There are doubtless those who, for reasons relating to the structure of the English Language, will disagree with me, but please bear with me and I will offer a contextual explanation of my stance later.

The use of the terms by HMRC of “clients” or “customers” for taxpayers is completely inappropriate.

The Title of Tax Inspector

On a further issue of titles, by the time this book reaches print, the description “Tax Inspector” will have been superseded by descriptive terminology less “threatening” in nature, such as HMRC staff, compliance staff or whatever. This is absolutely a step in the right direction, albeit an incredibly tiny one. At the time of my penning the book however “Tax Inspector” is still in existence and widely used. Alternative terms such as “HMRC staff” and variants thereof are too cumbersome, it’s my book, and I shall continue to describe “them” as Tax Inspectors.

The Subject of the Book

This book considers formal Tax Investigations conducted by Civil Servants, Tax Inspectors employed by HMRC. In practice there are various types of Tax Investigation (also termed Enquiries) addressing a variety of duty collection regimes such as Self Assessment (S/A), Pay As You Earn (PAYE) and Capital Gains Tax (CGT). Whilst there are certain technical differences between them they can conveniently, for the purpose of this book, be grouped together under the umbrella term “Tax Investigation” and treated as if they relate to Tax Investigations addressed in HMRC’s Codes of Practice 8, 9, 11, 14 and others.

The Target Audience

This book was intended originally, simply to be a useful guide and reference work for anyone, be they an Accountant, or a Tax practitioner, or a layperson, who is either self employed, or works in a similar capacity such as the Director of a Limited Company, having a degree of personal liability for the tax liabilities of their organisation. For simplicity, hereafter, I have used the all embracing term “self employed” when referring to those in the latter category.

It was only as I worked through the subject material that I increasingly realised that the roots of the issues and adversity stem not primarily, or even largely, from individual Tax Inspectors per se. It is an undeniable fact that there are ongoing issues and that they derive, in part, from interpersonal situations. However a very significant proportion of the problems, issues and impropriety associated with Tax Investigations stem from severe flaws in the overall nature and ethos of structure of The HMRC System under which they are conducted.

I continue to write primarily from the perspective of assisting the taxpayer and his accountant. I have however tried hard to present

matters in a balanced way and, in so doing, I have tried to put at least some of the points across in such a way that individuals who are integrally part of the HMRC System may be enabled to see things from our perspective.

The following example is a deliberately “trivial” one, intended for Tax Inspectors to consider. Suppose that in good faith, you (the Tax Inspector), had purchased a motor vehicle, used it innocently for several months, and then received a letter from an authority explaining that there were reasonable concerns that the vehicle had been used inappropriately in some criminal activity. The letter went on to say that, to use a commonly heard type of phrase, **“the potential of your involvement in that activity needs to be considered so that any possible relationship between you and the suggested activity can be eliminated”**.

Consider conversely the receipt of a letter in similar circumstances, along the lines **“we will investigate any situation involving your vehicle where we suspect serious criminal activity. The investigation will be undertaken with or without your voluntary co-operation”**

I am completely confident that pretty much any reader who is not a member of HMRC will be able to fully understand the point being made here. Tax Inspectors too will be able to understand the difference between the two letters themselves, but to what extent will they be able to relate to the synergy of the two examples, and relate them together to the situation that taxpayers subject to a Tax Investigation find themselves in? It has been suggested that I am being optimistic in the extreme, but I hope that the target audience will extend itself to relevant representatives of HMRC, and perhaps Her Majesty’s Government itself and that reading this book with an open mind may in some way enable improvements to come about!

Intended originally for a target audience of tax professionals and the self employed, this has been extended somewhat to bring a balanced view of the

shortcomings of the system to the attention of those within HMRC who are in a position to bring about essential changes in the system.

Technical Issues

The book deliberately does not address, except where contextually necessary, technical aspects of Tax Investigations which are more than adequately covered elsewhere in numbers of other publications. It also studiously seeks to avoid references to legislation and case law except in the instance where it is necessary in the context of the subject material.

Human Aspects

Rather than consider technicalities the book focuses substantially on the human nature of aspects of Tax Investigations, the interactions between the parties and the issues and the ethos underlying these. Many readers will be aware that the approach of individual Tax Inspectors towards their work is different from how “professional” people will conventionally behave in relation to conventional business negotiations. There are valid and understandable reasons for this, and an understanding of those is crucial to understanding how successfully to achieve our targeted outcome to the Tax Investigation.

This book focuses on aspects of the “human nature” side of Tax Investigations and interpersonal interactions.

3. THE SYSTEM THAT IS HMRC

Tax Inspector Recruitment Training and Reward

Before we can move on to examine how to work within the System effectively it is essential to have a thorough understanding of the Tax Inspector, where is he coming from and why? It can be very difficult for those of us who are self employed, or even just working in a competitive commercial environment to understand this. The following is an extract from HMRC's recruitment web site in June 2009. It briefly sets out the Career Structure of the Inspector and is, as can be seen, a very attractive package, particularly perhaps for a student graduate used to surviving on loans.

http://www.prospects.ac.uk/p/types_of_job/tax_Tax_Inspector_salary.jsp

- “1. Starting pay for recruits joining the Tax Inspector development programme is £23,929 nationally, £26,010 in London (salary data collected March 07).
2. After four years, at the end of the training programme, you can expect to move into a pay band commencing at £42,586 nationally, £47,735 in London.
3. Even while gaining experience and confidence on the programme, trainees can enjoy pay rises and promotions.
4. HM Revenue & Customs (HMRC) do not operate a long-hours culture.... flexible working hours are widely available.
5. Part-time, job share and term-time only working are potentially available to everyone, as are special leave and career breaks. HMRC offer generous maternity, adoption and paternity leave, and are fair-minded about other

needs and requests.

6. Work is mostly carried out in district tax offices.
7. There may be confrontational situations, which can be stressful [I make no comment about this, save that I wonder how many self employed wished that their job description provided for just the odd confrontational situation].”

Coupled with salary increments based on performance this is potentially a very attractive package for a recent university graduate, particularly so for the keen trainee potentially able to secure a promotion whilst still gaining experience and before even the completion of training. I am frequently asked whether the salary of Tax Inspectors is directly related to the financial value of the settlements they achieve. Do they for example receive a percentage cut? My understanding is very specifically no that they do not. Their salaries are however directly linked to “performance” generally, as might be defined in the general structure of any junior managerial role, and as might be expected by junior managers in similar employment situations.

For reasons best known to HMRC itself I have not been able to locate much data on the current terms and conditions and service of civil servants generally. However, in my time, the annual holiday entitlement was of the order of thirty working days along with bank holidays in England and Wales of eight working days. I also worked a System of flexible hours that gave me a significant degree of control over how my working day was organised and provided the potential for additional days away from the office. It was feasible to gain a further eighteen days absence from the office annually on the flexible hours scheme by working (relatively) long hours on the days in work, thus accruing the necessary monthly hours of attendance in less days. My understanding is that the current conditions of employment are not significantly different.

Adding these possible absence figures together, and given a five day working week, the Tax Inspector is potentially able to achieve a paid absence from the office annually of some ten weeks or more. As we have seen from the job description above there is a collection of other allowable absences from work, including a generous sick leave entitlement not mentioned there. In addition there is the other unidentified benefit of a “fair- minded” approach to other needs and requests.

I do not propose to say any more about the terms of employment and I will leave the Reader to ruminate how all this compares with the lot of the ordinary self employed.

A Tax Inspector’s annual salary in London can approach £50,000. With the ability to arrange the working day within a system of flexible working hours, some thirty days annual paid leave and paid bank holiday absences, the Tax Inspector may be able to achieve some ten weeks or more paid absence from the office annually. His salary is not directly related to the financial value of Tax Settlements achieved.

This then sets the scene, at least in part. We have our Tax Inspector possibly working his way through training. This training will be provided, at least to a very great extent, by seniors in his peer group System who will themselves have gone through an almost identical training process. As you will begin to see shortly many of the issues associated with Tax Investigations stem from what I consider to be failings in the System that must inevitably be passed on to successive generations of trainees by similarly trained trainers as an ongoing process.

What follows below is an extract from the training section of the http://www.prospects.ac.uk/p/types_of_job/print/tax_inspector.jsp web site.

“The [training] programme starts with a six-week core module, followed by modules covering technical tax issues and communication. It is a mixture of practical work experience in teams, formal study days, tutor-led sessions, self-study, exams and practical assessments with regular reviews and appraisals. Trainees are allocated mentors as well as supervisors. The programme leads to an internal qualification...”.

Note that there is absolutely no reference to interaction with or experience of the reality of industry in the big outside world, and this isolation from the reality of the working life forms part of a theme that underlies many problems that we will discuss.

Tax Inspector training is largely theoretical, offers little experience of the world outside the Civil Service and is delivered largely by HMRC staff who themselves may have been trained in a similar fashion to the new trainee.

The Mindset of the Tax Inspector

Having briefly discussed this within the Overview let us now return to and look more closely at the concept of the individual Tax Inspector functioning within the System. Remembering always that we are talking **not** about the individual in the context of his private life and how he performs socially. Remember also that even having discussed the fact that his power and authority is limited, this is not necessarily how the Tax Inspector, or the taxpayer, perceives the “power” situation. I have explained this “junior management” concept to countless taxpayers over the years. This “third party” knowledge of reality, as passed on by me, does little to assist an individual in overcoming his understanding of a situation and to allay his inherent fear of the unknown.

I frequently hear the phrase (about HMRC staff) that “they wouldn’t last five minutes in the real world”, but what exactly does this mean? On the self employed side of the fence, be we shopkeepers, company directors, accountants or whatever we do not have a System to support us, into which we can be absorbed and which, in turn, supports and assists us. We survive or fail pretty much entirely as a result of our own endeavours. Conversely, the System that is HMRC carefully looks after and supports and nurtures its employees, and makes available a huge variety of resources to help those employees. What is the point here?

Essentially, the Tax Inspector doesn’t exist in the real commercial world. This isn’t a criticism, simply a statement of how the System works. Expressed very simply here and returned to later - we need those taxpayers, who are our customers and clients, and upon whom we depend for an income. To the Tax Inspector they are simply cases to be worked.

Whilst the rewards for the Tax Inspector from his employment may be regarded by some as substantial, his working life is far from glamorous. It is primarily desk bound with no “real” contact with or experience of the outside commercial world. Life within the Tax Inspector’s working environment is compartmentalised and follows a cyclical daily process of working through an allocated caseload. Like all civil service junior managers he will be subject to some form of supervision from line management and the degree and intensity of this will vary from situation to situation.

As we have seen from the job description even the stress factors of working life are described as that “he may be subjected to some stressful experiences”. The Tax Inspector inevitably has little experience of the day to day types of traumas to which the self employed are subject on an ongoing basis. This is neither in any way a criticism of the individual person nor even the System in which he is ensconced. It is simply a reflection of the situation.

A further and very important point to note is that in the conduct of his work the Tax Inspector doesn't deal with people, as individuals, as such. He is a case worker, in an office environment, working a selection of cases allocated to him. Apart from technical ones he may make no distinction between living persons, human beings, and non living legal persons in the form of Limited Companies. He does not interact, at a personal level, with the subject of Tax Investigations and has neither a need, nor a means of relating to, the personal consequences to the individual of what he does.

He may pay lip service (a term not meant unkindly) to the fact that there are very real individual consequences of what he does, but this is nothing more than common courtesy. He is simply working a case and this again is not a criticism. Where the objection starts to cut in is often the manner in which the individual chooses to work the case.

It is for the foregoing reasons that I take the offence to which I have previously referred at the use by HMRC of the term "customers", or "clients". Regardless the strict dictionary definition of the terms, in reality our customers and clients are people with whom we interact, and with whom there is, between them and us, a mutual ongoing inter dependency on one another. Within HMRC taxpayers aren't customers at all, as noted they are simply cases to be worked.

Accountants, for example, by virtue of the very thing they do are closely involved with people. They often work for the same individuals over a period of time and develop understandings of their circumstances. In particular they understand the consequences of the Tax Investigation on the individual client.

The Tax Inspector is a case worker, ensconced in a particular working environment, working cases as opposed to having a working relationship with individuals. This is not a criticism of the individual Tax Inspector who has little if any control of the definition of his working environment. It does however

enable us to understand why the behaviour of individuals may seem strange to us.

Differences and Issues at the Interface between Taxpayers, Accountants and HMRC

And it is here, at this interface between different perspectives and approaches that the roots of adversity lay, and where the cause of many of the adverse interactions between Tax Inspectors and the self employed originate. Right and fair minded members of society must inevitably disapprove of theft, which of course is what tax fraud is. The tax man isn't fair game as was the perception of many historically, and money misappropriated from the treasury simply impinges on the well being of the remainder of the general public who have to pay more tax as a consequence. It is generally recognised that all members of society should pay their share of tax, the amount properly due, and that those in arrears with their tax liabilities must "catch up".

The situation however is not black and white and is FAR from being straightforward. I have come across many situations where, had it not been for specialist intervention (an observation not intended vainly) the taxpayer might have paid substantially more than he was liable to pay, not because he had defrauded the System, but because he was unable to prove that he had not done so.

In such circumstances the perception of the "truth" is not necessarily what occurred but what can be demonstrated as having occurred. We address the issue of proof in some detail later. One significant issue that I have with HMRC is that they tend to require absolute proof whilst being fully aware that peripheral evidence such as a sworn affidavit may well be acceptable. We return later to issues of conflicting responsibilities within the overall remit of HMRC.

Additionally we live in a humanitarian society. Yes, people have to pay their dues, but in this respect also the situation is again far from straightforward. The consequences for individuals and their families of catching up with arrears (regardless the reasons why they arose in the first place) can be devastating. The rights and wrongs of the System could well be the fruitful subject of a large and totally separate book and I do not dwell on them here. At this point I am simply looking briefly at the interface between that Tax Inspector's perspective and that of others.

At the interface between Tax Inspectors and others, the mindset between the two is likely to be very different.

The lifestyle of many of the self employed revolves, inevitably and to a very great extent, around work related concepts. The need to get new work in and keep existing customers happy and loyal, getting paid for work done and the like is fundamental to their lives. They are subject to significant pressures which derive directly from a need to survive financially. The success of what they do is fundamental to their lifestyle and how much money (if any, literally) is available to spend.

The Tax Inspector's situation however is entirely different. Having been accepted into the HMRC fold and having served some sort of probationary period he becomes established in his work situation and, unless he does something way off the planet he is pretty much guaranteed a job for life. Furthermore not only does the Tax Inspector potentially have a job for life but he also has a guaranteed income, albeit that the quantum of that income may vary in accordance with his work performance. Whilst the finite amount of that income is not guaranteed, it is certainly going to be there long term, subject again only to the caveat that he must not step significantly out of line. In the background, for the future, the inevitable prospect of a substantial public sector pension is always there.

At this point I wonder whether the Reader may be reflecting as to why Tax Inspectors are always so well dressed, polite and politically correct. It is what is expected of them by virtue of the nature of their employment. Remember however that when you meet a Tax Inspector who is conducting a review of a case, you are not engaging in a mutually reciprocal professional business relationship.

The concept for example of a business person after attending a meeting with us the previous day, and then issuing a letter along the lines “thank you for your kind hospitality at yesterday’s meeting; you owe us £1,000,000.....!” is pretty much alien to us. It simply isn’t how things are (usually) done in the world of commerce, although there are of course exceptions. Many, many actions of Tax Inspectors are completely incongruous, like for example shaking hands and similar civil niceties. Would you shake hands with a detective investigating you, a prosecutor prosecuting you, or a debt collector taking your assets? Of course not!

The lifestyle of the self employed revolves to a very great extent around work related concepts, for example the need to get new work in and keep existing customers happy and loyal. The Tax Inspector however is working a case, not engaging in a mutually reciprocal business relationship.

Of course by the same token life out here in the real competitive world is equally an unknown factor to the Tax Inspector. He has absolutely no experience of the kinds of pressures - financial and otherwise - to which we are subject, nor is he able even to come close to appreciating them. The following example comes to mind which, whilst I suspect it will bring a wry grin to the Readers’ face nonetheless emphasises how significant the lack of experience of reality is, in considering the actualities of situations.

Consider the case of a small corner shop type business where the Tax Inspector was “concerned” about the relationship between wages and turnover, the former being somewhat lower than might be expected

by reference to the size of latter. The shop was open from 8.00 am to 10.00 pm seven days weekly – a total of 98 hours. The staff worked a limited number of hours weekly leaving the proprietor working the bulk of the time, fitting in also cash and carry visits, trips to the bank and the various other necessary tasks.

Lead wholly by his theoretical training the Tax Inspector “found it difficult to believe” that a proprietor would work such long hours. The Tax Inspector’s assertion was that it was inevitable that the proprietor had employed other staff, who were being paid in cash from suppressed sales, and who were not being the subject of PAYE deductions. The proprietor was challenged to prove that this was not occurring.

We of course know the alternative reality of the situation faced by the proprietor. The business, like many similar ones, was struggling and in the harsh reality of life the proprietor was required to put in the hours or face closing down. But how can anyone prove a “negative” situation such as this?

The failure of HMRC to adequately train its staff in the reality of working life can lead Tax Inspectors to views, conclusions and opinions that are substantially at odds with reality.

Tax Inspector Behaviour Regulation and Complaints

In relation to HMRC we need first to make a clear distinction between events that are statutory and appealable through an appeals procedure and actions taken at the volition of individuals, and for which they are responsible. In considering complaints we are looking specifically at the latter, the manner in which Tax Inspectors conduct themselves personally in the performance of their day to day duties.

I am no longer a party animal but many years ago, in my early working life things were different. There was a long established tradition within the culture of office workers generally that the last working day before Christmas was a day for winding down. Work stopped about midday to give way to the inevitable activities associated with alcohol and pub and the much looked forward to Christmas party.

I remember one particular such last working day when, like everyone else I was looking forward to the forthcoming activities when the District Inspector (DI) summoned me to his office. It was with a feeling of foreboding that I attended the summons where he expressed his extreme regret that I would need to miss the festivities. A “Member of Parliament” (MP) complaint had been received in respect of HMRC’s treatment of a member of the public. As a complaint this required immediate attention. The processing and action had to be started on that day so that the rigid timescale allocated for such issues could be adhered to. How, however does that compare with the lie of the land these days?

Over time there have been very significant changes in management styles and structures generally, not just within HMRC but in the Civil Service generally and indeed throughout the UK and globally. Structures have become less regimented and complaints systems generally have increasingly tended to look inwards to deal with complaints internally. If the issues I raised here were to derive from complaints stemming from me alone it might well be considered that I am a discontented individual with some axe to grind, but they do not derive from me alone!

I frequently deal with cases which have been passed to me by other accountants who are not content with the actions of particular Tax Inspectors. I have worked on those cases and in respect of some of them encountered similar problems to the previous accountant. Over the years I have raised significant numbers of complaints over a wide range of issues, and those issues have frequently been such that other professionals too have been concerned about them.

Yet not on one single occasion has a complaint been upheld or, as far as I can establish from responses received, resulted in action being taken to rectify the future situation. There appear to be only two possible conclusions to this scenario. The first is that I along with all the other professionals who have been discontent with situations got it wrong on every occasion, whilst HMRC got it right every single time. Alternatively there is something inherently wrong with the complaints procedure. At one point I had managed to convince myself that the fault must inevitably lie with me, but I have since recovered from that depressed situation.

I have raised significant numbers of complaints over time in respect of a wide range of issues. Many of these have been referred to me by other accountants because they had been discontent with the action of individual Tax Inspectors. Not a single one of those complaints has been upheld! Did HMRC get it right every time, whilst we got it wrong every time?

Regardless whether the complaints were justified or not, what further avenue, if any, is available to me in order to have the matter further considered if I disagree with the outcome?

- There is certainly the option of a further review, or perhaps reviews within HMRC at another tier, but is there any reason to assume that the response to that will be any different? We have already considered that those administering the training system have themselves gone through the same in-house training procedure. Inevitably therefore, the same will apply to those administering the Complaints process and many if not all of those, will have been similarly trained to the subjects of any complaint. It must follow therefore that those administering the complaints procedure will have perspectives and outlooks in relation to the performance of work that will be similar to those individuals whose actions have been the subject of complaint.

- If the foregoing does not produce a satisfactory response there is the potential to complain to the Adjudicator's Office. The last letter I saw from that office, just a few days before this book went to press was dated 28 July 2008. The following is a quote from that letter. "We are currently working through a backlog and are unable to respond to written or telephone requests for updates." The letter is dated some eighteen months ago and, my understanding from its recipient, is that a reply has still not been received from that office!

There are a couple of exceptions to the foregoing internal complaints procedure but these relate to separate matters which are potentially very serious and possibly criminal, and which may be considered by the Independent Police Complaints Commission (IPCC).

HMRC is the most prolific revenue generating entity in the country, an organisation with a massive degree of discretion as to the treatment of taxpayers generally. Is it right that it administers its own complaints system (aside from very serious ones referred to the Independent Police Complaints Commission), and is responsible for the censure or otherwise of its staff?

4. ISSUES WITH HMRC

The General Treatment of Tax Fraud

Tax issues almost never result in a Criminal Prosecution by HMRC, although there are some exceptions and the reader may recall two high profile cases involving an entertainer and a sportsperson that hit the headlines some years ago. Given the rarity of prosecutions they are not discussed as a subject in this Book. The vast majority of cases are concluded by a Contractual Civil Settlement, which follows on automatically at the conclusion of any Tax Investigation leading to a need for an upwards adjustment of the taxpayer's liability. A contractual civil settlement provides that the taxpayer will enter into an agreement with HMRC to repay tax undercharged, along with interest and such penalties as are appropriate. The settlement might provide for the payment of all the duties in one lump sum, payment by instalments over time, or a combination of both.

The investigation of tax offences rarely results in a criminal prosecution and is generally concluded by a contractual civil settlement.

HMRC: Situations and Adversity

Adversity is very specifically **not** my preferred option. It is stressful for all concerned and I endeavour always to take things forward, at all times, in a manner of sensible cooperation and compromise. Unfortunately this is not always possible and significant parts of this book, as the reader has already seen are about dealing with adversity, and how to cope with situations where our perspective differs from that of the Tax Inspector.

These differences in perspective manifest themselves in a variety of ways. For example where requests made by HMRC are perceived as unreasonable, or where the taxpayer is potentially going to be faced

with an alleged liability which he potentially does not “owe”, but is apparently unable to disprove. A common example is a situation where funds have been lodged with a private bank account. The Tax Inspector has required evidence in the form of the third party’s bank account from which they were originally drawn, but that document is not available to the taxpayer.

This is the “Dark Side” of the System where the accountant or taxpayer believe that things are going wrong, but there is no apparent means of dealing with the issues that have arisen. It is a simple statement of fact that all involved in Tax Investigations, are human beings subject to the same frailties and weaknesses as fellow members of the human race.

What is inevitable, in any situation where at the interface there are individuals with totally different perspectives, is that human nature will cut in and that the individual with the perceived upper hand will frequently win out over the other “weaker” individual or individuals.

This section of the text has been omitted as a consequence of legal advice received.

Significant parts of this book are about dealing with adversity and how to cope with situations where our perspective differs from that of the Tax Inspector. Actual examples that might have exemplified this have been omitted as a consequence of legal advice.

HMRC’s Internal Disputes

We discussed under a previous section, “The Tax Inspector’s Mindset” that the roots of diversity and the many ongoing adverse interactions between Tax Inspectors, the self employed and their professional representatives stem from their different perspectives, approaches and mindsets. The first iteration of the book was one which was very critical of the Tax Inspector in this respect and

contained examples which were withdrawn as a consequence of legal advice received. As I have worked through the book I have increasingly realised that the fault lies primarily with the System, as opposed to the individuals who work in it, and this final version of the book is presented in a changed format from that originally intended.

Lest the reader become concerned that I have become “pro” HMRC let me reassure you that this is **not** the case and the next section looks specifically, and in detail, at how to deal with issues relating to Tax Inspectors regardless whether responsibility for those issues lies with the underlying System of HMRC. For the moment however, I am perusing my quest for a balanced presentation, and taking a look at the underlying issues.

The following description and criticism of the Self Assessment System is a sweeping generalisation aimed at highlighting just one underlying theme. An attempt to address it fully would need to cover far more areas than I as a private individual could possibly address in a modest book such as this. However, the underlying problem is that the whole structure of conduct of the Self Assessment System by HMRC, in so far as it relates to the control of tax abuse, is grotesquely underfunded and completely incorrectly structured. As a consequence the operational remit of individual Tax Inspectors and the System they help administer is intrinsically and inherently beset throughout with contradictions to the significant disadvantage of taxpayers generally.

I am not going to do anything more than simply scratch the surface of the subject here, and I am certain that there are many more capable people than me juggling the need for change against the finance available, in the powerhouse of the Treasury. Nonetheless, like other accountants I see and have to contend with the inequity on a day to day basis and, as I believe I mentioned somewhere else previously, it’s my book, and, as such, I am going to have my say!

Rather than work through pages of text on page after page I am going to use the relatively simple example that follows as an introduction to the concept that I wish to illustrate. It is a real life example and the real cash consequence for the business, the amount the business may have to pay HMRC, is of the order of £1/4m.

The situation was one where the taxpayer had been running a business in a loss making situation, and those losses had been offset against other income over time. The business had been running for some eleven years, having claimed relief in similar circumstances in each year. Having decided to raise the Tax Investigation the Tax Inspector conducted a meeting with the taxpayer which lasted approximately twenty minutes. It is clear from the notes of that meeting that little insight into the actual business structure, its aims and purposes was obtained.

The Tax Inspector may have had some, or even a significant knowledge, of the overall nature of the industry, and from that knowledge I accept it was **questionable** whether the losses claimed were allowable. Decisions however cannot, or at least should not be made on the basis of what happens elsewhere. On the basis, essentially, of this information alone however, the Tax Inspector **issued his decision letter** that the Tax Relief granted historically was to be withdrawn.

When I say decision letter HMRC has argued that they hadn't issued a "formal" decision letter. They had "simply" told the taxpayer how much had been over allowed, that he had been criminally negligent, and even the penalty he was going to pay. Yet again I shall leave it to the reader to deliberate what exactly constitutes a "decision" letter, and the extent to which the taxpayer is expected to know the difference between the different types of standard letter that HMRC chooses to use.

It is poignant and significant in the extreme that I have been able (hopefully) to adequately describe, in just a few lines, the considerations given by a Tax Inspector, to an issue with a financial

consequence of £1/4m! Of even more concern is how very simple it is to describe such an achingly large flaw in the system. I knew and still know little about the industry but, by spending just a couple of hours talking through the machinations of the business, and the proprietor's hopes and aspirations, I was able to see that there was a reasoned prospect that he **might** indeed qualify for the relief that had been granted.

The details of the specific case are completely irrelevant. The issues we discuss here very specifically are nothing to do with whether the tax relief is due or not. The issue is the actuality of the situation and the manner in which individual HMRC Tax Inspectors work within the system.

Working within the requirements and parameters of the System, Tax Inspectors may fail to give appropriate consideration to all the factors of the case as we may perceive them.

Human Aspects Considered

Having said early on that the book is about human nature, not technicalities, the case in the previous paragraph provides an excellent opportunity to explore specifically the human aspects of a situation. In the first instance the formal appeal procedure is technically available, but there were other separate aspects to the Tax Investigation, and the formal appeal procedure was a very long way away. The main accountant himself was a completely competent well experienced individual so what was the problem? The facts were as follows.

- The Tax Inspector had issued his decision letter disallowing the relief.
- The decision was based on his “understanding” of the facts, which was in effect his understanding of the industry.

- The accountant, regardless his very clear competence is an accountant whose duties are the preparation of accounts and associated bookkeeping procedures. He is not an “investigator”.
- The Tax Inspector is the “investigator”, the person charged with considering the facts of the case.
- The Tax Inspector, on issuing his decision letter had invited the taxpayer to submit any additional “**evidence**” he may have to support his claim.

What evidence? What are the respective positions of the horse and cart here? Surely one gathers the evidence before coming to a conclusion?

- What is the accountant supposed to know about the machinations of an industry about which the Tax Inspector had chosen to use his time to research? Bear in mind please that the Tax Inspector was paid a salary whilst taking time to undertake the research. The accountant can expect no such luxury and clients who will shell out hard earned cash to fund research are few and far between, and my argument of course is why should he? If HMRC chooses to challenge something it should do it properly.
- How is the taxpayer to be expected to be able, in practice, to convert his knowledge of his industry into evidence that the accountant can use?

Who should take the Lead?

- So the human aspect of the situation is that the accountant, undoubtedly very competent as an accountant (his job) had no realistic knowledge of how to gather evidence as an investigator would have done.
- The taxpayer knew his business and industry well, but had no means by which to convert this information into useable evidence.

- The responsibility for assimilating all the evidence before coming to a decision must inevitably rest with the Tax Inspector.

An interesting feature of this case was the nature of evidence gathering. His argument throughout was that at his twenty minute meeting the taxpayer had the opportunity to demonstrate that the losses were allowable. He was completely blind to the problem that the taxpayer had no knowledge of how to do so. The information however was there. I extracted it from the taxpayer by specific questioning, and if I was able to do so then the Tax Inspector should have been able to do likewise.

A decision making process should involve assimilating all the evidence and then coming to a decision.

What next? We have a number of different factors and angles.

- Having interviewed the taxpayer for a couple of hours, and spent some time developing an understanding of the industry, we established that the situation is far from clear and that there are arguments in both directions.
- The situation is not one in respect of which the solution rests in precedents.
- HMRC may not agree but I would argue (very strongly) as I guess would most readers, that the Tax Inspector really should have examined the case much more fully before coming to a decision.

The bottom line is the following.

- The taxpayer hasn't done anything "wrong".
- It's a judgement call whether or not the relief is due or not. The same judgement call would have applied in every one of the past eleven years.
- Is it morally right that the taxpayer should have, essentially, to face financial ruin now, when it was an issue that could

very easily have been considered by HMRC in any one of the earlier years?

- We would argue strongly that the TAX Inspector erred significantly in his treatment of the case, and was very firmly in the wrong.

Where next?

At the time of writing I have produced a factual assessment of the balance of probabilities on a points basis of 100 allocated to the positive or the negative and the balance has swung marginally in the taxpayer's favour. Other factors to bear in mind remain that the taxpayer may have been in the "wrong" for claiming the relief, (a very big maybe) but the Tax Inspector was definitely in the wrong. Two wrongs may not make a right but maybe there is scope for their wiping each other out. Then there is the morality or otherwise of the potential consequence. We now have to see the outcome of the debate that will now follow. Progress on this case will be posted on my web site.

The case in this example started out very negatively for the taxpayer but careful examination of the facts has, at the time of writing, pushed the analysis of the balance marginally in his favour. This, along with associated "human" issues may well swing the argument fully in his favour.

A Compromise Solution to a Case similar to the Previous Example

The case was similar in that the situation was uncertain whether historically granted relief over a similar period was allowable. Case law was not in the taxpayers favour, nor was the balance of probabilities, so HMRC had the "lead". There was deadlock with the

potential for a complex technical appeal, arguments about the applicability of precedents, with significant costs to both sides.

As we have discussed in relation to HMRC's internal disputes, somewhere along the line HMRC must inevitably cross the intractably impossible and inappropriate boundary between negotiation, and pursuit of a conclusion in favour of the Crown, and that pursuit was well in place.

The solution was to take a firm stance and to be clear to HMRC that a prolonged battle leading to an appeal would be undesirable, and disadvantageous to the public purse. On the one hand we were prepared to recommend a reasoned compromise settlement. With such quid pro quos on both sides it was possible to take an overview and thus come up with a compromise.

Given the general uncertainty, it was possible to compromise and come to an agreement that those earlier years would be treated as with the intention for profit (even this was marginally, in contradiction of case law), and the relief claimed for earlier periods was allowed. A cut off point was agreed, at which it was accepted that the intention for profit had ceased and it was agreed that liability would run from this point. Interest (statutorily) was charged for this latter period, but not penalties. Even the potentially swingeing consequence of the interest was ameliorated in that it applied to the later years only.

The moral here was that common sense can be brought to apply but it requires a very firm approach.

The saving of a Tax Inspector's working time, and thus the consequential financial saving to the public purse, can result in a quid pro quo compromise settlement, in circumstances where a compromise settlement might otherwise not be feasible.

Briefly what the Issues within the System are

Moving on now from an inability to complain, which has now been well enough flogged, let me try and explore more fully, albeit briefly, what the issues with the System are. Take as a starting point a comparison between the responsibilities of the police forces that investigate crime and bring accusations, and the court system, the judicial arm of the law system that follows on and administers justice. I am not going to go into any minutia of the comparison. The situation is completely straight forward and in essence there can be no intermingling of their respective responsibilities. Whilst there may be some exceptions to this statement, essentially they are completely separate responsibilities.

As the reader doubtless guessed, the next step is to compare the combined functionality of those two organisations with the functionality of HMRC. The comparison and the conclusion is equally as straight forward, HMRC performs both the investigation function and also the administration of justice itself. It is a complete incongruity! Going along with the previously expressed theme the problem with the system lies much, much deeper than the scope of this book and the purpose for which it has been written.

I am restricting myself to summarising below just one of the contradictions and issues:

1. HMRC is charged with the responsibility of ensuring that the taxpayer pays the correct amount of tax, not too little, but not too much either.
2. HMRC is charged with the responsibility of conducting a **pragmatic review** of a case having regard to all the facts.
3. HMRC considers such cases ongoing, with a view to bringing them to an appeal process if necessary.

4. In an appeal situation HMRC is charged with the responsibility of **presenting the case on behalf of the Crown.**

Tax Inspectors are ordinary human beings subject to the same frailties as all of us. At which point does an individual Tax Inspector switch from being an “independent” arbitrator to a prosecutor?

I actually got to number 20 on the list of contradictions before coming to a decision that to continue would be a personal indulgence, and not what the reader was likely to want to read, and I have concluded it here.

An underlying problem of the System, in so far as it relates to the control of tax abuse, is that it is grotesquely underfunded and completely incorrectly structured. As a consequence the operational remit of individual Tax Inspectors and the System they help administer is intrinsically and inherently contradictory, to the significant disadvantage of taxpayers generally

There is a plenitude of examples of this, and I quickly arrived at twenty before deciding that this line was unlikely to represent what the reader wished to read. I restricted myself to just four points which briefly considered the contradiction of the role of the Tax Inspector as “independent” arbitrator and prosecutor.

5. CASES, ISSUES AND EXAMPLES

The General Nature of Tax Investigations

Having recognised that a great deal of the problem relating to the conduct of Tax Investigations is attributable to the system we nonetheless have to work within it effectively, regardless the underlying reasons of the problems. From the very start of the Tax Investigation it is necessary to take a stance that is clearly recognisable. It must be clear to the Tax Inspector that we understand exactly the nature of his work, that a factual, pragmatic assessment of a situation is being conducted, and that the exercise should be confined to that and nothing else. The Tax Inspector may have thoughts, suspicions, feelings, whatever else about the case but unless they are relevant to the issue under consideration we do not wish to hear about them. The taking of this stance is of course the start of another interface, an interpersonal one between primarily the accountant and the Tax Inspector.

Leading on from this we must establish a work methodology that constrains the Tax Inspector, and focus the Tax Investigation so that it proceeds in an equitable manner. We must, in essence, sidestep the system and provide for the taxpayer, in association with the accountant, to take control of the Tax Investigation away from the Tax Inspector. Clearly the Tax Inspector will remain on the scene but the accountant takes over the general conduct of the Tax Investigation.

There is absolutely nothing wrong with this approach, nor should it give rise to adversity. HMRC encourages the taxpayer to cooperate and make disclosure and we are simply helping to facilitate this. As a “bonus”, if such a thing is possible in these circumstances, we are also helping the taxpayer to potentially achieve a lesser settlement by maximising the potential for penalty mitigation for cooperation.

We are now ready to move on to a consideration of some of the issues associated with the conduct of a Tax Investigation and how to deal with, or even better how to prevent, some of the adverse circumstances that frequently arise in respect of them. Let us first be clear that we are discussing cases where we aren't content with the Tax Inspector's approach to the case. We are not considering situations where, for example, the taxpayer himself is occasioning delays in the submission of documents and where there is real hindrance of progress by the taxpayer.

The taking, by the accountant, of responsibility for the case, is completely in keeping with the concept of enabling the taxpayer to demonstrate maximum cooperation. As a "bonus" it enables the taxpayer to benefit from maximum possible penalty remission for cooperation.

Working the Case

Dealing with Tax Investigations may well involve the use of technical arguments, the interpretation of case law and the like. These are discussed briefly, and in context, as they relate to particular situations. As noted however from the outset, this book is not a technical one, and I am not addressing any detail of case law and the like as it may relate to a particular case. Our take on "Working the Case" is to take a holistic view of as many issues as possible pertaining to the taxpayer's circumstances, and it is extremely important to stress that cases should **not** be considered at face value alone.

Always take the broader perspective! Look carefully at the whole case, the correspondence, the approach of the Tax Inspector, whether his underlying rationale is sound or flawed. Remember always that the system itself is fundamentally flawed, and that much of what it is potentially possible to achieve revolves around the politics of the situation. To put this into context I am starting off with a couple of

examples of situations where the day was saved by a solution that was indirect.

Example 1

Processing Tax Investigations is not necessarily restricted just to paperwork. Take a non profitable farm claiming loss relief and challenged, some years down the line as being a hobby, and not a business conducted with the intention of profit. The figures of losses spoke for themselves, it was argued, but there is no law in the land that requires a business to be run at a profit in order to establish that it is in fact a bona fide trading entity. The solution is of course to establish and demonstrate exactly what the facts are, and what better way to do this than to spend a day in the country? Physically visiting the farm and understanding the day to day activities creates a much stronger negotiating position than that of an individual whose understanding is restricted to the figures alone.

Add a camera into the equation and we are in a position where we can create a comprehensive report not only discussing the facts, but supporting them with clear visual evidence. For example at such and such a time the proprietor is up to his knees in it, using a particular piece of equipment to muck out the cowshed, and so forth. It thus rapidly becomes apparent that this is no gentleman farmer playing at it, but an individual working hard at a trading venture, with the realistic intention of profit, regardless the degree or otherwise of its success.

It ostensibly wasn't a cheap report for the farmer, but compared to the consequences of several years retrospective withdrawal of loss relief for the true cost it was peanuts. These days a good camera has been added to the sound recording and other equipment that I take everywhere with me.

Evidence is not necessarily restricted to figures and the written word. Photographic evidence can be invaluable.

Example 2

The need to take a holistic approach and look at the whole case is not related only to interactions with HMRC. The following example relates to a situation where the taxpayer was the sole director of a Limited Company (The Principal Company) which had entered into written contractual arrangements with a number of suppliers of its product. One of the terms of the contracts provided for payment by the suppliers, to the Principal Company on supply of the product. An “informal” arrangement was in place that provided that the suppliers were not liable to the Principal Company until they themselves had received payment from their customers. The Principal Company had accrued £1m of “income” in respect of supplies of product for which it had not been paid because the suppliers had not, and potentially were not going to be paid by their customers.

One of the “Big Four” accountancy companies had been paid a substantial fee to review the situation which it had done by reference to the accounting standards and the like. It concluded that the income had been accrued and there was therefore a tax liability thereon. The only salvation on offer was the possibility of relief for bad debts. I had been approached in desperation as a last possible hope. I was a little disappointed that I had been the last resort as opposed to the first port of call but that’s the way things go sometimes.

The situation was actually straightforward, but finding it required a step back, and an objective view from a distance. In English law (the law to which this contract was subject), contracts and terms thereto can be written spoken or inferred. The moment you jump onto a bus, no words may be spoken or documents exchanged, but an inferred contract comes into being that you will pay the fare and that the bus will deliver you to the destination on its route. This is actionable at law.

Individuals may agree to a course of action which they perceive is an informal one. In doing so however they have created legal relations and something which both parties agree is what is intended to happen becomes a variation to the terms of their contract. What had been perceived as a simple informal arrangement was therefore a spoken variation to the contract. The variation thus provided that liability to the Principal Company by the suppliers did not arise until the suppliers themselves had been paid.

There was not therefore any liability for the suppliers to pay the Principal Company in respect of funds which they were owed, but for which they had not received payment. The Principle Company had not therefore accrued any income. Ancillary issues such as proving the verbal agreed variation to the contracts and the like are addressed by a number of means such as, for example, the use of sworn affidavits, which is addressed later.

The need to look carefully at every angle is not restricted to issues associated with HMRC. Look inwards at the internal circumstances of the case.

A Cautionary Note for Tax and Accountancy Professionals

Our task, as agreed by HMRC, is to obtain the best financial solution available to the taxpayer within the parameters of the law. I have previously discussed how the System isolates Tax Inspectors from becoming involved in the personal implications of the outcome of a Tax Investigation. By a similar token we professionals must be fastidious in recognising the danger of becoming too involved in outcomes and their personal consequences. With no disrespect to any reader intended I am simply sounding a cautionary note.

I know how difficult it is in those circumstances where the taxpayer has not erred other than to put himself in a position where he cannot

prove the actual events of a situation and is going to be substantially penalised.

I am occasionally asked by taxpayers how they can “fiddle and get away with it” but it is simply a no go area for me. There is a very significant distinction between utilising the rules legitimately to maximum advantage and breaking them. My answer always is to stay within the rules and I will help them develop situations which are to their advantage within the parameters of the law.

There is a significant distinction between making a valued judgement, and making the mistake of unintentionally putting forward unsustainable arguments, something that could put us in a position of ourselves being vulnerable to criticism or possibly worse.

Avoid studiously the danger of becoming too involved with the taxpayer and the consequences for him of the Tax Investigation.

I was approached by a taxi driver who was the subject of a Tax Investigation. An examination of his private account revealed that he had banked several tranches of amounts of fifty thousand pounds or so over a period of a couple of years. His explanation, about which he was insistent, was that he had accumulated it over past years, and had now decided to bank it. I should mention that for at least the past several years he had been resident in a caravan!

The explanation was clearly ridiculous in the extreme and I dropped him like a hot potato. I have no problem, as a general rule, in endeavouring to achieve the best financial settlement available within the parameters of the law. In this case however it was clear that the funds must have almost inevitably been derived through some sort of “serious” criminal activity, money laundering perhaps, drug trafficking whatever, and as such I was having absolutely no truck with it. I am very clear in my mind that I will not assist in a tax related sense, any cases where I suspect that funds in question have

been derived from alternative criminal activity, particularly those involving drugs, people trafficking, prostitution and the like!

It is however necessary to make a distinction in that this book is about how and what to do in relation to Tax Investigations only. I do become involved in criminal cases, for example criminal confiscation orders after conviction associated with proceeds of crime issues, but that is totally separate matter and not addressed here.

Unlike many solicitors we have a choice with whom to choose to work. It is the judgement of the individual Tax Professional who he chooses to work with. My advice is to steer very well clear of any case that potentially involves any form of “serious” criminal activity.

Recording Meetings and Telephone Conversations

It can be extremely useful to have recordings of conversations and there are, as far as I am aware, no restrictions regarding recording meetings and conversations generally, certainly I have never encountered any objections. Recording of telephone conversations without announcing that they are being recorded is however a totally different kettle of fish!

It is for the Reader to satisfy himself as to the law but the following is my understanding, of the situation, and it is one that has never been challenged. There is absolutely no requirement for an individual to notify the other party to the telephone conversation that it is being recorded, and there is no need even to introduce beeps and the like, to give an indication that recording is taking place.

The recording thus made cannot however be released to any third parties without the specific consent of the other person who was recorded. Even this limitation is not necessarily restrictive and can be used to very good advantage. At an Industrial Tribunal in relation to unfair dismissal the relevant telephone conversations had been recorded but the appellant who had been dismissed refused to give consent for the recording to be released to the Tribunal.

The solution of course was straightforward and the recording was taken to the tribunal where the Lady Chairperson was invited to consider why the appellant was disinclined to have the facts aired. When asked by her, the appellant was unable to offer any reason other than that the recording had been made without her consent. This was regarded as unsatisfactory by the Chairperson who took the view that the recording existed and that she wished to hear the facts and what had been said. The appellant was given a further opportunity to permit the recording to be heard and she declined. The appeal was dismissed.

There will of course be those Readers that will object to this concept of unannounced recording on various grounds such that it is an intrusion into personal liberty. Clearly we are all entitled to our personal opinions which must be respected by all.

In wider life I would be inclined to agree myself that this is an intrusion. We need to bear in mind however that the discussion here relates to potentially inappropriate conduct and behaviour by those in a position of significant authority, acting in the conduct of their official duties. The situation must inevitably beg the question that if playing back a recording is not appropriate then should the words spoken have even been uttered?

Recording general conversations, meetings and telephone conversations can provide exceptionally useful data material. In the case of recordings of telephone conversations, where the third party has

declined to consent to the release of the material, the existence of the data may still be constructively used.

HMRC's Internal Instructions

HMRC instructions published on the Internet are an interesting innovation over fairly recent years. In so far as they relate to procedures and the like their presence is fairly mundane. One area which I view with considerable lament is the manner in which case law is defined and interpreted within the instructions. This has led over time to a situation where we find ourselves discussing not the case law itself but HMRC's interpretation of it.

Being somewhat long in the tooth I recall well the "good old days" where we were able actually to discuss case law with a Tax Inspector who might occasionally refer to "Chief Inspector Claims" (CI Claims) if the point at issue was contentious. These days dialogue about actual case law is not easy to achieve and the Tax Inspector will tend to try and direct the conversation to HMRC's interpretation of situations. Precedents are discussed later and I am not going to get into them further, as such, here. I simply wish to emphasise that HMRC's instructions have absolutely no weight at all, and should be regarded as for the guidance of the office staff at HMRC.

Online instructions published by HMRC are ostensibly suggestive of pretty compelling stuff! For us they are NOT in any way compelling. The online instructions are essentially little more than HMRC's instructions to its staff on the conduct of their affairs.

The Burden of Proof and the Evidential and Shifting Issues

When a self employed person becomes the subject of a Tax Investigation the frequently mistaken concept of the layperson is

almost inevitably some variation on the theme that he (the Tax Inspector) can look at me and my records and see that everything is in order. There is frequently a belief that the Tax System is some sort of mechanical process whereby if something has occurred, it is sufficient for the event to have occurred and that is the end of the matter. For example if a cash gift of £5,000 is banked into a private account the common belief is that because it was a gift that is the end of the matter.

This concept however is completely incorrect and a very clear burden of proof exists. Not only is there the burden of proof, but that burden rests at least initially (subject to important caveats that we discuss later) on the taxpayer. It is critical to understand that tax law is a “negative” law, the only example of UK law that I know of that is such. Take for example a situation where an individual assaults someone at a crowded football pitch. There are countless witnesses, the police are called and the individual who undertook the assault is arrested. Regardless that he can clearly be seen to have been guilty the State still has to prove his guilt and the assailant does not have to say a single word in his own defence. If the State fails to prove, beyond all reasonable doubt, that he undertook the assault then he is innocent of the alleged crime. So whilst in other situations it falls upon the “accuser” to prove guilt, this is not the case with tax disputes. The onus falls fully (at least initially) on the taxpayer to demonstrate that his taxation affairs are in order and that they are as they have been portrayed by him.

The actual burden of proof however is a very long way away from the “absolute” burden of “beyond any reasonable doubt” that applies in Criminal Prosecutions. Whilst tax fraud in itself is a criminal offence, all of the situations considered in this book are dealt with not by prosecution but by a civil contract settlement procedure, whereby the taxpayer contracts to repay duties to the State. The burden of proof is in fact the civil one of the balance of probabilities. This means that the decision on the validity of a particular point should be based on whether it is more likely (more than fifty percent) to be accurate than not (less than fifty percent).

Going back to the situation where non-trading deposit of £5000 is paid into a private bank account. The Tax Inspector may typically wish to see concrete evidence of the party source of the funds, for example a third party bank account from which they have been drawn. If such firm evidence is not available then it is likely that the funds will automatically be deemed, by the Tax Inspector, to be suppressed trading receipts and taxed as such.

If contested the Tax Inspector may refer to the fact that this established procedure has been determined by precedent (precedents are discussed in a little more detail shortly) and that's all there is to it. What the Tax Inspector may fail to take into account is that precedents apply only to cases with identical circumstances and that each case must be judged on its merits. The supply of third party bank statements, even if they are available at that time, will almost certainly raise issues of confidentiality and the demand for them must be looked at in the context of the specific case.

There are very possibly other forms of evidence that can be submitted, for example a sworn affidavit may well be appropriate and we have recently concluded a case where HMRC acknowledged that the point in dispute was adequately addressed by such a document. Even if the Tax Inspector is reluctant to accept such evidence he may well be disinclined to take a case to appeal where the evidence weighs against him winning.

In relation to evidencing situations generally always remember that the burden of proof is the balance of probabilities and not an absolute one. Consider each case on its merits; is the Taxpayer's version of events most likely to be the accurate version? It can be difficult to "face off" a Tax Inspector but always remember that he is a salaried civil servant. You do not have to back down if he is intransigent and he cannot force closure against your will! The only entity that can require final closure is the appeal system or, exceptionally beyond that, the judicial one.

The Tax Inspector is unlikely to take a case to appeal that he has a very questionable chance of winning.

We have so far looked at the situation whereby the taxpayer is required to prove his situation, but this need holds true only in the broad, general sense. In a circumstance for example of an assessment simply being raised, without HMRC making any comment as to why, then the burden of proof does indeed fall on the taxpayer to demonstrate, if he disagrees with the assessment, what the correct figure should be. There are however important exceptions.

At the time of writing, HMRC's instructions are almost entirely silent on the burden of proof issue. There is a brief reference to it in their conduct of appeals guidance at AH1320 which can be seen at this web site:

<http://www.hmrc.gov.uk/manuals/ahmanual/AH1320.htm>.

The following is a relevant extract which advises the Tax Inspector on the conduct of appeal hearings.

“As well as the burden of proof as to quantum on the appellant there is a second burden, usually called the “evidential burden”, that is capable of shifting back and forth during the hearing. Once evidence has been given, then the evidential burden rests on the person who would fail if no further evidence were produced.

In a tax appeal this means that when the appellant has put forward evidence in support of his contentions, you in turn must put forward evidence which rebuts the appellant's evidence. This is done partly by cross-examination and partly by introduction of your own evidence. It is not always necessary to adduce evidence to meet the evidential burden. It might be sufficient to address the Commissioners on the basis that they are not obliged to accept everything they have been told by a witness.

Once all the evidence is in, the Commissioners have to look at the totality of that evidence and see whether the appellant has discharged the primary onus of proof which lies on him. If he has not, the decision must go against him, but if he has then obviously he will win. **It is therefore very important to pay attention to the way that the evidential burden shifts as the hearing progresses. If you fail to counter facts and evidence as they emerge you may find that you have not discharged the onus which has shifted to HMRC.** In Tax Investigation cases, see also EM5672/3.”

The extract also makes further reference to AH2225 and AH2130. The former either no longer exists or has been removed from display and the latter states “This text has been withheld because of exemptions in the Freedom of Information Act 2000”.

It is interesting that HMRC is focused on discussing the evidential burden in relation to an appeal hearing, yet says absolutely nothing about it in a general sense. If the evidential burden can shift to the Tax Inspector at the final stages of the dispute then it must follow that in preparing his case he must, or perhaps more to the point, **should** have regard to this potential situation in dealing with cases generally.

Extrapolating the principle backwards I always argue strongly that the Tax Inspector is responsible for demonstrating that any assertions made during a Tax Investigation can be sustained on the balance of probabilities. Following on from there I would argue that the moment that the Tax Inspector makes some definitive statement, as opposed to phrasing a question, the burden of proof in respect of that statement shifts to him. I refer to this as the “Shifting Burden of Proof”

In the case of the evidential burden of proof, a Tax Inspector can be required to justify an assertion at appeal. It is reasonable to expect him to be able to do

likewise throughout the negotiation and debate processes of the Tax Investigation itself!

Similar Cases may be Subjected to Different Treatment by HMRC

The potential for the disparate treatment of cases that are similar in principle is an interesting further point from which to explore the failings of the System. I deal, on an ongoing basis, with numbers of serious cases where criminal prosecution has been considered by HMRC, but where a decision has been made, possibly in association with other enforcement agencies, to proceed down the Civil route. I address the detail of the treatment of such cases later, but for the moment suffice it that the Reader knows that these fall into a category described as Code of Practice 9 (COP9) cases.

The COP9 System is quite a tightly regimented one, or at least it should be, with just eight regional offices throughout the UK. One might therefore reasonably expect a significant degree of uniformity of treatment in respect of these cases. A feature of COP9 is that in return for receiving immunity from prosecution the taxpayer agrees to fund an accountant deemed as “acceptable” by HMRC to prepare a disclosure report. A target timetable of six months is set for the preparation of this Report, after which HMRC reserves the right to assume responsibility for the conduct of the Tax Investigation itself. It is important to be clear that timetable is completely discretionary on the part of HMRC, and individual Tax Inspectors have discretion whether to adhere to it or not.

At the time of writing for example, I have one COP9 case which has been dragging on for almost a year without any action from us. For tactical reasons relevant to the specific case I have contacted HMRC on three occasions and specifically pointed out that there has been little action on our part. I have suggested that the Tax Inspector may

consider it appropriate to “push things along” but to date the case remains stalled.

What follows are two examples of cases that are essentially similar in principle but which have been treated totally differently.

Different Treatment; Example 1

One of these cases involves a taxpayer who has deliberately and consistently defrauded the System of substantial sums of money over a significant period of time. In so doing he built up a fairly substantial Property Empire. The case has been going on for two years with the taxpayer having spent a significant amount of time outside the UK so that little progress had been made during the initial six month discretionary period. Nonetheless the Tax Inspector dealing with it has held off from assuming responsibility for the Tax Investigation and has responded positively to various requests that I have made, sometimes to take a particular course of action, sometimes to hold off on another. Instead of marching in with hob nailed boots he has held back and been extremely cooperative.

The situation is now reaching closure and the settlement will be one that has been derived by cooperation and the application of common sense. The taxpayer will achieve the best financial terms available within the parameters of the law, and the Tax Inspector will have a solution that he can “sell” to his seniors. Lamentably this kind of outcome is not common.

Different Treatment; Example 2

The second example again involves a situation regarding property. The issues are significantly less serious than the former example, far less money is involved, over a much shorter period. The taxpayer has had severe difficulties with the administration of the business, and had also been unwell during the initial six month discretionary

period. Nonetheless the Tax Inspector in this case had decided, even before the expiry of the initial six month period that he would take over the case. A significant consequence of this is that the taxpayer could potentially be deprived of significant penalty mitigation for cooperation.

Equality of Treatment in Principle

In situations where the circumstances of individual cases may be different but the underlying principles are similar the method of treatment of the one case, as compared with the other, as with many human issues, may vary dependent on the circumstances and nature of the individual handling it. HMRC may argue that the circumstances of one case cannot be compared to another. This is true as far as the content of the cases is concerned. We are however entitled to expect that the principles governing the treatment of cases are consistent.

HMRC may argue that the circumstances of one case cannot be compared to another. This is true as far as the content of the cases is concerned. We are however entitled to expect that the principles governing the treatment of cases are consistent.

Payments on Account

This is yet another area that is far from straightforward. On the one hand the rate of interest levied by the Treasury may be regarded as substantial and the argument of making payments on account of any perceived additional liability eventually to be agreed exists, although it is not one to which I subscribe.

Certainly making a payment on account may almost inevitably have the effect of reducing the interest payable in respect of any overall

settlement. It may not however result in a reduction in the overall sum payable in respect of such a settlement. I have heard the conduct of a Tax Investigation being likened to a game of poker. If this is the case then the ability of the taxpayer to make a cash payment at some point, possibly at the end of the Tax Investigation, may be a useful bargaining tool, and may well play a significant role in the calculation of the overall settlement.

Making a payment on account may inevitably result in a (slight) reduction in the overall interest payable in respect of a final settlement. Cash in hand however, must inevitably be an extremely useful bargaining tool in relation to settlements as a whole. Once a payment has been made it is no longer available to the negotiation process.

Precedents

Let me first explain that I have only minor legal qualifications and that I am not competent to speak with authority about the law in this respect. Therefore what follows in relation to precedents is my understanding as a layperson, although I believe that it properly addresses the subject. Precedents generally are well covered in Criminal Law, 11th Edition, 2005, (ISBN 10: 0406977305).

Precedents are frequently quoted by Tax Inspectors. However it is important when considering precedents to understand that they are the “legal rules” established by judges when deciding cases. It is these rules and specifically not the Court Decision that is the important factor. These rules are broken down into separate sections the relevant ones being *ratio decidendi* and the *orbiter dicta*. The main component of the “precedent” is the former, commonly shortened to *ratio*. This is the legal rule that sets the precedent. Interestingly it is undefined in law. It is however described in Zander (The Law Making Process 6th Edition, 2004, ISBN 10: 0521609895) as “a proposition of law which decides the case, in the light of the

material facts”. It is this that constitutes the binding precedent. The latter, the *orbiter dicta* also has significance although I am not going to dwell further on technicalities.

It is critical to be clear that a precedent can apply only to a case where the circumstances quoted are identical to the circumstances of the case under consideration. In my experience the understanding of individual Tax Inspectors of this point, and of the applicability of precedents generally, in so far as such understanding exists, is limited if at all. Where therefore a circumstance exists where a case put forward by HMRC is dependent on the application of precedents, there may be very significant scope for bringing it seriously into question.

When precedents are quoted, the situations to which they refer apply in situations where the circumstances of the case being quoted are the same as the circumstances of the case under consideration. Always check carefully whether the circumstances of precedents quoted by HMRC are applicable, whether in full or in part, to the case in question.

Affidavits and their Uses

An affidavit is a formal sworn statement of fact signed by the originator, the deponent, and witnessed as to the authenticity of the deponent’s signature by a taker of oaths, such as a notary public or commissioner of oaths. They are very persuasive in situations where absolute evidence is not readily available. I am not aware of any formal precedents relating to their use but I have correspondence on file from HMRC establishing, to a certain extent, this as a principle.

Affidavits, sworn on oath, are potentially very persuasive as evidence. I am not aware of any formal precedents relating to their use but I have

correspondence on file from HMRC establishing this as a principle.

An Example of the incorrect application of Precedents and the use of Affidavits

This brings me onto a two legged argument associated with the following example. I am aware of my undertaking not to involve the reader in technical areas but this so well fits the bill that I simply couldn't resist introducing it.

S118 (1) ITEPA 2003 and S168 ICTA 1988; BENEFITS ALLEGEDLY DERIVING FROM THE PRIVATE USE OF A COMPANY MOTOR CAR.

The issues in this case related to the alleged availability to the Company Director of the private use of vehicles owned by the company and the consequent liability to commensurate benefits. There were two issues provided for by the legislation.

1. Was there an effective prohibition in place preventing the Director from using the company vehicles privately?
2. Were the vehicles used privately?

The case primarily quoted by HMRC in correspondence, in relation to 1. above, was *Gilbert v Hemsley* (55TC419) which specified the following.

- There must be an express ban on private use.
- That there must be a legally enforceable ban on private use.

The case was an extended one over time and HMRC were intractable. They claimed that “on the evidence available” it had not been possible for the Director to have been prohibited from using the vehicles privately. Additionally the challenge posed was that he could not demonstrate that he had not used them privately.

Issue 1

We will consider the first leg here. Was there an effective prohibition in place? The legislation quoted in the online manuals was S118 (1) ITEPA 2003 and S168 ICTA 1988. It was not in fact the legislation on which HMRC relied, but its interpretation of it as reflected in their on-line instructions. As we progressed through the case it became clear that HMRC’s interpretation of the case had not been appropriate.

As a result of careful examination of the case we were able to identify a note of a company meeting where the Company Director had expressed the view that he should not use the vehicle privately. Then by reference to *Gilbert v Hemsley* (55TCA19) what Mr Hemsley had actually been told by the managing director when he was given the car was that it was “for business use and that he was *not expected* to use it for private purposes”, and this was accepted by the judge as satisfying the test.

Drawing a comparison with the case in hand HMRC accepted that the evidence identified in the meeting note was sufficiently persuasive and acknowledged that “any tribunal would find that the prohibition in this case was strong enough”.

This illustrates clearly that references quoted by Tax Inspectors to HMRC’s internal instructions should never be accepted at face value. In particular we do not need accept the “rulings” of Tax Inspectors who very specifically do not have the last word. I try and work every case in the same way. I establish as best possible the facts, stick to my guns, and keep an eye open for areas of possible compromise that will favour the taxpayer.

We do not need accept the “rulings” of Tax Inspectors who very specifically do not have the last word.

Issue 2

This is a frequently faced conundrum! How can it be possible to prove that something did not occur? In a case of this nature, realistically, the only possible way would have been to have maintained a record of all the business use of the vehicle, thus demonstrating by default that there was no private use. The proposition is ridiculous. There were absolutely no records of mileage, but we arranged for the Company Director to swear an affidavit on oath that he had not used the vehicle privately and this was accepted by HMRC who responded as follows.

“...Although I would have preferred sight of service records and service and repair invoices you have provided the affidavit.

The reality of the situation is that Mr X has given evidence that he never used the car for private purposes and, unless I can disprove this or at least seriously discredit his evidence, it would be accepted by the tribunal.

In view of my observations outlined above I am now prepared to accept this as the situation.....”.

HMRC is clearly on record as having accepted, in principle, that affidavits must be accepted as forming very persuasive arguments.

Contracts Generally

Bear in mind always that the negotiations leading to a “Settlement” are in fact negotiations leading to the drawing up of a Contractual Civil Settlement. The Tax Inspector may know little about contract law and that civil contract settlements are in fact contracts subject to the normal terms and conditions of contract law. He may thus make statements which he regards as being simply glib, off the cuff ones.

In English and Welsh Law, with certain exceptions such as contracts relating to land (the law in Scotland may be different), the terms of a contract can be written, spoken or even inferred. Just as a general point, and clearly depending on many factors, be aware that any statement made by a Tax Inspector may just be one that can be deemed to form part of the contractual settlement, to the taxpayer’s advantage. The odds of it being so are not high, but there is always the possibility. It comes back always to look at all aspects of every case and to keep reviewing everything about it.

In English and Welsh Law, with certain exceptions such as contracts relating to land, (the law in Scotland may be different) the terms of a contract can be written, spoken or even inferred. It may be possible that statements made by Tax Inspectors can be identified, by us, as forming part of any contract settlement to the client's advantage.

Cash Issues

The appearance of cash, the source of which cannot be explained, lies at the heart of so many problems that it requires a detailed explanation.

Cash Hoards Generally

A major issue in many Tax Investigations is the presence of cash, the source of which cannot be unaccounted for. It is generally assumed by Tax Inspectors that accrued funds with no demonstrable source such as a third party bank statement is taxable. It is then down to the taxpayer to demonstrate that this take on the situation is not correct. “Unsupported” explanations of gambling or betting wins, gifts, loans and the like are deemed absolutely no go areas automatically, and that, generally, may be a perfectly reasonable and acceptable stance.

The issue however is what does the term “unsupported” mean in relation to earlier comments about the applicability of the balance of probabilities. First off there is absolutely no law in the land that I know of that requires that accrued cash funds must be lodged with a bank or other financial institution. From there on we need to look carefully at the context and circumstances in which funds have accumulated and if the explanations put forward by the taxpayer are reasonable. If they are reasonable then it is unacceptable that the taxpayer should be penalised simply because he choose to accumulate funds in cash!

Capital Introduced

Similar considerations apply to Capital introduced into a business as apply to cash hoards generally.

The potential for the Inappropriate Taxation of Cash Accruals

If the taxpayer is completely unable to offer an explanation for the accumulation of cash then it will be taxed. There will however be circumstances where HMRC will seek to treat cash accruals as suppressed sales in the absence of **absolute** evidence, but where such

treatment is not necessarily appropriate. In those circumstances it is for us to consider whether there is any way that we can identify evidence that, on the balance of probabilities, will swing the situation to the taxpayers favour. Consider please the following two examples.

Case 1

Take the case of the public house landlady who accumulated a collection of one pound coins from her personal drawings, and stored them on the window sill of her bedroom as a means of saving. She then banked the cash when it reached £750.00. Whether this was a sensible thing to do has absolutely nothing to do with the issue, but prima facie HMRC would try and assume that it represented suppressed sales.

When she and her husband went on holidays they employed a relief manager who stayed overnight at the pub and used the landlady's bedroom in her absence. She was able to attest that she had seen such collections on occasions when she had slept there. Even though there could be no absolute proof of what had occurred the testimony by the relief manager could well be sufficient to swing the balance of probabilities to the taxpayer's favour.

Case 2

Take a situation where a taxpayer has borrowed some money in cash but not maintained appropriate records. When the subject of a Tax Investigation has been shown to have erred in a particular year HMRC automatically assumes that if the business activity existed in previous and subsequent years then they will assume that as the taxpayer has erred in the year in question it is inevitable that he will have done likewise in those years also.

They will therefore fairly automatically project the adverse tax conclusions backwards and forwards. Say in this example the taxpayer had borrowed £4000 in one year. Then given, typically, a backward extrapolation of six years and forwards extrapolation of two years, the taxpayer is going to be faced with an additional tax and national insurance liability of the order of ten thousand pounds. Add the inevitable interest and penalties into the equation and he faces a debt potentially of the order of twenty thousand pounds!

But what has he actually done wrong? In this case he has done nothing more than borrow some money and failed to keep proper records. Typically the Tax Inspector will require evidence such as sight of the lender's bank statements to support the loan and equally as typically we realise that the likelihood of these being obtainable is negligible. If the Reader is an accountant he will know the next stage. The Tax Inspector is likely to decide that the evidence is inadequate and the taxpayer has to account for the tax due on what are perceived as being suppressed sales. There is of course the option of an appeal but, in reality how likely is it that the Taxpayer will choose to go to one. The Tax Investigation has been going on for ages; he has spent a substantial sum on accountancy fees, lost time in work dealing with the paperwork and just wants closure and the return of his life to normality.

So what can be done to save the situation? If the taxpayer's account of events is genuine then there may well be scope for retrieving the situation in accordance with our old balance of probabilities ally. The following are just a couple of the areas that could be considered, and there may well be others depending on the specific circumstances of the case:

- What was the nature and volume of the cash drawings shortly after the loans were received? Are they suggestive of an ability to repay the loan? We might see for example relatively high cash drawings in the period following the loan. If there was a pattern of this after each loan this would be strongly suggestive to the positive.

- What was the taxpayer's bank balance at the time of the loans - in credit or overdrawn? If overdrawn, was it at the upper limit? An individual may be able to demonstrate by reference to the attendance records of a casino and the nature of cash drawings that he plays regularly at the casino. When he wins is it likely that he may bank those winnings.
- We have already noted that there is no law requiring that cash funds be banked immediately! Suppose an individual accrues small amounts from drawings and banks them piecemeal. This is the kind of thing that people in self employment do. It is worth bearing in mind that it may well be unlikely that a Tax Inspector who gets his salary paid directly into his bank account at the end of the month would save in this way. Incidentally this therefore is another example of the dangers of Tax Inspectors being distanced from reality.

Regardless that the Tax Inspector demands concrete evidence of a particular situation, for example cash transactions, the principle is always the same. Remember that the ultimate test is the balance of probabilities.

There is an almost if not entirely infinite gamut of permutations possible on the theme of verifying cash accumulations. The approach to take is to consider carefully the circumstances of the individual case, and to and identify possible forms of evidence that can be used to substantiate a situation.

The Treatment of Cash within different Cultures

This is a very different kettle of fish with significantly different implications and considerations. It is a simple fact of life that the UK is increasingly being populated by a variety of cultures with varied ethnic roots. These can have very different conventions, traits and

means of conducting their day to day activities from those of, say, the “traditional” English family (for want of a better description). It is very easy these days to fall into the trap of being accused of racism so, for the absolute avoidance of any doubt let me be clear that I have absolutely no bias towards or against any culture, ethnic group, religion or gender. I am simply addressing the facts as they present themselves.

Considerations of cases in this area are of particular interest to me, and I am dealing with numbers of cases where this is a significant issue. If the Reader knows of a case to which these considerations apply I would be very interested, please, to learn of it.

Within the traditional English family it would generally be extremely unusual for individual cousins and others loosely related to one another, to make substantial loans to one another. Even in those circumstances where it did happen appropriate formal documentation would almost inevitably have been prepared, signed and be available as evidence.

In numbers of foreign cultures however, I am widely informed that the practice is very common, and is indeed part and parcel of everyday life. I frequently hear of instances where an individual asks his cousin for some cash and it is simply handed over on trust and repaid accordingly. HMRC may well endeavour to attribute the source of those funds to suppressed sales, quoting various precedents in support of the action.

When we look at an exchange of cash without supporting documents in respect of a culture where such an incident is likely, and compare it with an exchange where it is unlikely, culturally, we are looking at two entirely different sets of probabilities, and hence two entirely different sets of circumstances.

We have already considered that precedents can be properly applied only to situations where the relevant circumstances are identical in

both the case under consideration and the case being quoted. We need to think carefully about this however. Clearly individuals resident in the UK are required to adhere to UK laws. The issue here however isn't about adhering to the law but its interpretation.

Considerations of cultural issues incidentally need not be restricted to those of cash alone.

The method of treatment of cash can vary enormously within different cultures. A precedent is created by reference to the specific circumstances of a particular case. If the culture of those involved in the creation of a precedent case is inherently different from that of the case under consideration this may have a significant effect on the applicability of the precedent.

Cash Flow Tests

A Cash Flow Test is a procedure commonly used by HMRC and in the correct context is appropriate. It considers the running balance of cash income available to the business to meet cash expenditure, and the accruing cash expenditure. If the amount of cash expenditure up to a point in time exceeds the cash available then there is clearly an "overspend". The business has spent cash that it cannot have without some other explanation. The running balance and cash expenditure are set to zero and the test recommences from that point in time. Any further cash overspends in the period under consideration are identified and the resultant totals demonstrate the amount of cash spent that was not technically available.

A relatively significant negative cash figure in respect of a large business with a formal Bookkeeping System would quite rightly raise questions and would very possibly lead to the identification of serious issues.

In practice however the Tax Inspector will frequently seek to apply this test to small businesses which are the subject of entirely different procedures and record keeping Systems. Take for example the proprietor of a small corner shop who visits his local cash and carry frequently. The time when he has to pay his VAT bill is upon him, he is short of cash, and so he borrows a thousand pounds from a friend or relative. It happens frequently in this kind of industry, is certainly not restricted to it, and extends into the wider world of cash businesses.

Our trader then repays the money over time out of cash drawings. Suppose this occurs four times in the year so that he has accrued a negative cash figure of four thousand pounds over the period. The tax and national insurance consequences of this in the year are of the order of, say £1,200.

Cash Flow Tests are appropriate in theory and in businesses where full formal records are maintained. In the world of the small trader their use must be viewed with considerable caution and their applicability challenged where appropriate.

Extrapolation

In relation to HMRC extrapolation means the extension backwards, forwards or both of additional revenues that are estimated to be due in respect of additional years. The extrapolated figures are based generally on the calculated figure of liability for the year of the Tax Investigation, adjusted in line with one or other of the various inflationary indicators that have appeared over time. With the exception of those cases where defalcations can be demonstrated as having been a one off event HMRC will inevitably seek to impose the extrapolation of additional liabilities, these days for increasingly extended periods.

This method of addressing earlier and subsequent years is not in any way set in legislation as the only way of addressing other years and is definitely not mandatory on the taxpayer. It is HMRC's shortcut solution to ending Tax Investigations quickly. Backwards extrapolation in particular can be a significantly expensive part of a Tax Investigation. Apart from the charge to tax there is also the interest charges that will have accrued over time and may be relatively more substantial. In severe cases where the extrapolation goes back for extended periods the interest charge may even exceed the tax due!

Proposals by HMRC to extrapolate duties should never be accepted without first checking that they are appropriate. There are two angles to consider in considering this check.

1. Has the taxpayer erred in other years at all?
2. If the defalcations stem numbers of years are the actual amounts in respect of those years likely to exceed, or be less than the proposed extrapolated figures?

If the answer to 1. above is no then the approach is simple enough, review the year before and the year after to encapsulate the Tax Investigation year and provide closure. If the answer to 1. is yes then we default to 2. and consider the extent of the review necessary having regard to likely differences and the potential cost to the client of so doing. Each case must be considered on its individual merits.

The method of review is straightforward enough. To conduct a full review of the whole of the activities of an alternative year or years would be expensive. It would also become increasingly difficult the further back we go, as the availability of records and accurate data inevitably reduces with time. The method generally that we recommend is to carry out a comparison only of those issues that have featured in the determination of the additional liability. HMRC may disagree and seek a wider exercise. The solution to this is that the proposed extrapolation itself relates to specific areas and that it is

both inappropriate and inequitable to extend matters further. If HMRC continues to object, one way of proceeding is to invite the Tax Inspector to undertake the review himself. That he will continue his objection is unlikely and I have never known it to happen. Be aware though that we have no means of preventing him from so doing.

A proposal to extrapolate figures backwards, forwards or both should never be accepted unless it is certain that to do so would not disadvantage the taxpayer. Additional years, as necessary, should be examined by the accountant.

A Comparison of Living Style and Funds Taken from a Business

In the case of a limited company funds will generally be drawn by the proprietor in the form of wages, benefits and dividends. Where the proprietor is self employed or in a partnership they are simply classed as Drawings. An examination of the level of funds taken from a business, when considered in association with other sources of income available to the proprietor, is a method frequently used by HMRC to consider whether sales have been suppressed. It considers not the level of sales themselves, but at the availability of funds available to sustain the proprietor's lifestyle.

The taxpayer's financial lifestyle is analysed in detail by reference to his personal expenditure across the board, day to day expenditure, holidays, mortgages anything that requires to be funded. A comparison is then made between the total expenditure and the total funds available to him generally, as drawn from the business, and from other sources such as, say, Social Security benefits and his partner's income. Various other features can be built into the test. If the expenditure exceeds the funds demonstrated as available then the taxpayer is called upon to demonstrate how he was able to spend

more than was technically available. Where, as may frequently be the case, those surplus funds are attributed to cash loans and the like from friends and relatives then considerations similar to those already discussed under “Cash Issues” apply and HMRC may seek to treat the surplus as suppressed sales.

An issue that commonly arises is where the Tax Inspector takes it upon himself to compare the taxpayer’s lifestyle as described by the taxpayer, with one or other expenditure indicator such as the Family Expenditure Survey (FES). Any suggestion by the Tax Inspector that the taxpayer has understated his personal expenditure should be firmly resisted unless the Tax Inspector has clear evidence to support his allegations.

When a taxpayer’s lifestyle and his ability to fund it is being considered by HMRC, the Tax Inspector may use an indicator such as the Family Expenditure Survey to endeavour to demonstrate a taxpayer’s income needs. Any such comparison should be firmly resisted on the basis that it is totally hypothetical and is not in any way indicative of the taxpayer’s real outgoings, lifestyle or income needs.

Profit Margins

These may be subject to attack from a number of different angles of which the following are just two.

A General Variation or Year on Year Fluctuations

This is a difficult area and one where the taxpayer can find himself very exposed. HMRC will generally suggest that it is entitled to assume that businesses which run on a similar basis year on year, for example a supermarket, will return similar margins year on year.

Where the margins fluctuate annually the Tax Inspector may pick on the year with the highest margin and claim that it is truly representative of the actual business achievement over time. Following on from this it follows he will almost certainly assume that sales in other years have been suppressed, increase the charge to tax in those years accordingly, and levy interest and penalties.

Experience has demonstrated however that there may be many valid reasons for these fluctuations and some of those within our experience are listed below. There are of course many more and in this respect we return inevitably to the need for a careful examination of all the facts surrounding each case.

- Take the greengrocer whose margin had varied year on year, in quite a dramatic fashion. Groceries, whilst having a substantial element of waste, none the less return a fairly substantial profit and the wastage on average will not contribute to the fluctuation. The situation in this case was completely straightforward and related to nothing more than changes in the trading activities whilst the business title remained unchanged.

Having started out as a relatively small village grocer the proprietor extended his activities to include canned product with a significantly lower margin, thus bringing his overall margin down. He then moved towards a more general store incorporating tobacco products and alcohol which further altered the product mix and had the effect of further reducing the margin. Newspapers and magazines were introduced, which attract a significantly higher margin and the percentage was seen to increase.

Latterly, having identified a niche market in alcohol sales relative to his location, groceries were abandoned and he became affiliated with a well know brand specialising in the large volume retail of alcohol. Volume increased accordingly but the margin again fluctuated.

- Other examples are the provision of inaccurate estimates of stock, debtors and creditors by the taxpayer. If the proprietor is insistent that there is no impropriety then clearly it is incumbent on us to get to the bottom of the situation. The answer must be there somewhere; it is simply a matter of finding it.
- One that should never be overlooked is staff theft! There are many ways of detecting and countering staff theft but these are not related to the subject of this book and are not discussed here. HMRC will take the view that if sales have been received, and then stolen, for example, from the safe after being recorded in the records, then the business is accountable to tax on those sales.

This however is completely distinct from theft at the point of sale where, for example in a cash orientated business where the takings have never even reached the till as the counter staff have pocketed them, there are strong arguments to support the contention that a charge to tax does not arise. In any situation where theft is suspected it is important, for two reasons, to involve the police if the taxpayer is agreeable. Firstly, of course, there is the obvious one of crime detection. The other reason, which is more relevant from the perspective of this book, is that reporting an incident to the police automatically produces a crime report number. This can be used very persuasively in any debate with HMRC as to the situation with regard to any theft.

I digress briefly from the immediate tax theme to mention an incident that is indirectly relevant. The subject was an exclusive restaurant. The margin week on week was down and, leaving aside the tax consequences, the proprietor wanted to know where his money was going.

We had been working the case for a while and tried a variety of tests, all to no avail. Covert surveillance and the like confirmed that bar

staff weren't drinking the profits or stealing cash from the till, alcohol wastage wasn't excessive, the proprietor wasn't having the cash so where was it? There was no apparent answer.

Purely by coincidence one day I was sitting in my car outside the business premises wondering where to look next when the chef emerged from the side of the building bringing out a succession of black waste sacks. It triggered a thought process in me. He was fastidious in the kitchen.....keeping a tight control of everything himself.....a long time friend of the proprietor.....and.....then.....as I thought "we haven't even considered him".....he carefully lowered a "waste" sack, and then another, and another over the adjoining wall.....I immediately knew.....and from the change of his position relative to the wall he saw me.....and he knew that I knew!

The police were called and the truth emerged. The chef had purchased a restaurant in partnership with another some way away. Courtesy of black waste sacks and the adjoining wall, he was supplying that restaurant with expensive products - champagne, caviar and the like - courtesy of my client by delivering it over the wall from whence it was later collected by the other partner.

Why is the method of detection of this instance of staff theft relevant to my conduct of a Tax Investigation? **Because the answer was there in the invoices, in the form of disproportionately high purchases of expensive products, but I had missed it.** The point is that there is (nearly always) an answer. My excuse for not spotting it? Well I was much younger and less experienced then. I wouldn't miss it now, I hope.

Whatever the issue the answer is almost inevitably always there, somewhere, it's just a matter of finding it by having an open mind and looking at all aspects of the case!

Suggestions of Under Achievement possibly by comparison with Trade Statistics

HMRC may suggest a comparison between the margin achieved by a particular business, and that regarded as “normal” for that particular trade or industry as a means of demonstrating the income potentially achievable by a particular business. He may then go on to suggest that the amount of cash difference between the two percentages is attributable to suppressed sales. This contention should be immediately refuted. It is completely and totally unacceptable that any Tax Inspector should even seek to compare a perceived “norm”, which itself must inevitably be an average, with the actual trading results of a business.

It is relatively straightforward to establish the margin that a business is, or at least should be achieving. It involves the analysis of a sample of all product lines, via purchase invoices, over a defined period of time. Again this is not the place for the technicalities such as sample sizes, frequencies and the like and there is an abundance of excellent texts on the subject generally available. We have a number of in house methodologies available to us if you have a case requiring such an analysis.

Attempts by a Tax Inspector to attribute the difference between the normal, or average achieved by a particular industry, and the actual result achieved by a business to suppressed sales should be immediately refuted.

Wages

There are a number of points of risk here, particularly in relation to cash businesses. In a cash business, it is relatively easy for the proprietor to suppress sales and pay some wages in cash before

recording the takings. Areas that HMRC will look at include, but are not restricted to the following.

- A comparison of the accounts figure with any formal PAYE records.
- The percentage relationship between sales and wages figures having regard to the type of industry.
- The actual quantum of the wages. Wages can be worked back via hourly rates to determine how many hours were actually worked. From there it can be deduced whether the deduction claimed for wages paid adequately represents the workforce. Note however that the Tax Inspector may automatically assume that the national minimum wage is in payment as a basis for his calculation. Whilst there is a law in force requiring a particular minimum level of wage payments, whether the taxpayer is actually paying at that rate does not automatically follow, and he may be paying below it.

A Tax Inspector's calculation may (inevitably) be based on an assumption that the minimum wage level has been met. If this is not the case, and the wage rate in payment has been lower than the national minimum, it may be possible to demonstrate that the actual hours worked overall are higher than the Tax Inspector's assumptions.

Whilst this may help to resolve the tax situation it must be bourn in mind that there will be alternative consequences to the proprietor if he has failed to meet the requirement on him to pay at or above the legal minimum rate.

The means of dealing with the issues that arise here is variously addressed in previous sections. If HMRC can demonstrate that suppressed sales have been used to pay wages they will seek to bring the suppressed sales into charge, charge vat and also possibly to penalise the taxpayer for failing to operate PAYE correctly.

In circumstances where HMRC can demonstrate that suppressed sales have been used to pay wages a form of “circular” argument is created. By attesting that suppressed sales have been used to pay wages then it follows that those wages must actually have been paid and, as such, they are available to add onto the deductions in respect of the wages in the accounts. This can at least limit the damage largely to PAYE vat penalties and interest. If HMRC seeks to resist this due to the absence of records simply point out that by reference to the balance of probabilities they themselves have demonstrated that the wages were paid.

Attendance by the Taxpayer at Meetings

Meetings are a particularly vexed area with HMRC variously contending that they are necessary to enable the taxpayer to demonstrate cooperation and for HMRC to obtain information. In the first instance there is absolutely no requirement in law for the taxpayer to attend any form of interview or meeting, and this applies also to COP9 cases. Furthermore there is no scope for criticism of the taxpayer if he decides not to attend a meeting, nor does his refusal disadvantageously effect his potential entitlement to penalty mitigation in respect of cooperation.

It would be useful here to draw a distinction between interviews that may be conducted by the police and those meetings held by HMRC. The essential purpose is the same, to determine information, but there are significant differences.

Generally police will not be on a “fishing trip” and will almost certainly be seeking information about issues that are specific and relevant to a certain period of time albeit that that time period may be some while ago. The subject material is likely to be something about which the individual will almost certainly have specific knowledge,

and which might well feature significantly in memory. Questions may be factual and relatively straightforward to respond to. Importantly the conduct of the police is monitored closely by the Independent Police Complaints Commission (IPPC) and complaints will be subject to careful scrutiny by that third party

Interviews with the Tax Inspector are however very different in structure, content and approach. The Tax Inspector's interest will not be confined to specific subject areas and will frequently cover a range across the spectrum of the taxpayer's life - business, social, domestic and pleasure. The issue of the lack of specific subject material and the fact that the subject may be expected to be able to address such a wide range of issues is very problematic and the concept absurd. How many of us know what we did last week, last month, last year or ten years ago, in respect of issues that were potentially one off and are long since gone from memory.

I generally refuse to attend such opening inquisition interviews while ensuring that I make it is clear that the taxpayer wishes to demonstrate the maximum possible cooperation and will answer any reasonable question that HMRC wishes to raise, but in written format.

There is no requirement for a taxpayer to attend opening, or indeed any other, meetings and a refusal to do so does not prevent a taxpayer from demonstrating cooperation in order to achieve penalty mitigation. If a decision is made by the accountant to attend a meeting the taxpayer should not be put in a position where he is subject to any unreasonable or unacceptable forms of questions.

Depth of Consideration of a Case

The subject in this case was a combined fish and chips and kebab outlet. HMRC had conducted a business economics exercise and come up with suppressed sales resulting in additional liabilities of forty thousand pounds in respect of the year of Tax Investigation. The shop had been established for many years and with extrapolation the total settlement sought was of the order of a quarter of a million pounds. The proprietor was distraught, desperate and adamant that he had done nothing wrong. My initial thought was one of staff theft. Incidentally staff theft issues are a frequent solution to suppressed sales matters, but they are not discussed in this book as they are not directly relevant to its subject.

A thorough examination of the records revealed a straightforward solution. The menu described kebabs as being sold with salad or chips but there were minimal purchases of salad items. A brief discussion with the proprietor revealed that most kebabs were sold with chips, which were supplied with the meal at no additional charge.

HMRC's business economics exercise had calculated the volume of chips sold as being sold as single product items all of which were sold at unit cost. It was now clear that virtually every sale of kebab represented a portion of chips given away without generating any sales revenue. In the business economics exercise this factor had been completely overlooked. A cross reference to the volume of kebabs sold confirmed that this fully accounted for the discrepancy. The Tax Investigation was closed without any adjustment and a bonus for the client was that we had identified a "loss" of income which he now had an opportunity of rectifying if he wished.

We have previously looked at the System and how insufficient resources generally are allocated to HMRC to facilitate the conduct of the Tax Investigations. This is a very clear example of the point being made there.

Mathematical / Presentation Errors

Calculations provided by HMRC should never be accepted at face value as they frequently contain arithmetical errors. There was the case, for example, of the excel spreadsheet calculation by HMRC that simply did not seem correct. The final figure calculated was clearly, on visible viewing alone, disproportionate to the column of figures and far too small. Admittedly it was something of a mystery as the “sum” formula at the foot was correct but checking the figures separately and arithmetically demonstrated a mistake of the order of magnitude of one of the figures in the column.

From there on it was quite straightforward and I quickly identified that the figure in question had had a comma typed in front of it so that Excel disregarded it from the calculation and treated it as text. The version of Excel used was a somewhat older one than the modern ones which put a marker in the cell and there was no visible indication.

Yes I realise that to err is human and the Tax Inspector had made a typing error but it’s a question of care. I spotted the mistake so why couldn’t she have done so? The file has long since been confidentially destroyed and I can’t recollect the exact amount involved but it certainly was substantial, possibly of the order of twenty thousand pounds.

Gearing and Capital Issues

Apart from Cash, which is addressed elsewhere, capital issues do not generally attract a great deal of attention and are not considered here.

Interest Charged by HMRC

There is little to be said here about the principles of interest being charged by HMRC as the provision to be able to do so is pretty much mandatorily provided for in statute. However, be mindful always of situations where HMRC has occasioned delays! Any delay occasioned by HMRC can cause an inappropriate loading of interest chargeable. In such cases calculate the excess charge cumulatively over time and seek to have it offset against the overall settlement as part of the negotiation procedure.

The provision for the charge of interest is statutory. If however HMRC has occasioned any delays during the Tax Investigation seek to have the settlement figure reduced by the amount of the excess charge.

Penalties

The situation regarding the method of calculating penalties is in a state of change, and is in any event technical and not discussed here. However, before accepting any penalty proposal conduct your own calculation of the amount you consider should be due. Compare this with HMRC's proposal, which you should always await before you consider disclosing yours.

If the figure HMRC presents is less than yours, clearly there is no point in disputing it and it can be accepted by default. If however their proposal is higher than yours then you require sight of the details of their calculations. Consider disputing them on the basis that you have already, separately, calculated your lesser figure. Remember that the inevitable desire of the taxpayer to achieve closure is likely to be mirrored by the Tax Inspector who, very often, will be disinclined to put up a strong argument to a reasonable reduction.

Never simply accept HMRC's proposed penalty without being satisfied that the proposed figure is properly and reasonably calculated.

Exit Strategies if All Else Fails

Unfortunately there must inevitably be occasions when substantial settlements of tax interest and penalties come about. The taxpayer may then find himself in the following situation.

- Regardless whether arrangements are made to make payments by instalments he has to find the resources to fund the settlement.
- Additionally he has to find resources to fund the activities, the shortage of which may have driven him to need to avoid paying the appropriate taxes.
- Associated with previous point he is now denied the additional cash derived from underpaying tax.

It is inevitable that in numbers of these cases the taxpayer will simply be unable to meet the financial demands of any settlement, regardless any relatively beneficial terms that it has been possible to negotiate. If this potentially is going to be the situation then the time to consider an exit strategy, in the form of a personal bankruptcy properly conducted within the parameters of the law, is at the outset of the Tax Investigation when the client still has numbers of choices and options open to him. As always therefore, this points to a holistic view of the case and a consideration of as many parameters as possible from the outset. That having been said, it is of course also entirely the client's decision whether it is a subject that he wishes to consider.

If the taxpayer wishes to go down this route there are a couple of important points that must be noted. First and foremost any exit strategy planning must be undertaken under the auspices and strict

guidance of a licensed Insolvency Practitioner. Additionally there are at least four golden rules that must be observed by the taxpayer, and which must never, under any circumstances, be broken.

1. In absolutely no circumstances should anything be done that is, or could in any way be considered to be dishonest in relation to obtaining finance.
2. Prior to bankruptcy an individual is entitled to dispose of assets but he must not give them away, as it may be possible for any such gifts to be overturned.
3. An individual may sell his assets, even to a connected party such as his wife. Any such sale however must reflect the full market value of the asset and must not be disposed of "undervalue".
4. Hiding activities from the Official Receiver, or failing to disclose assets to him is a serious criminal offence.

Part of the holistic consideration of a case, from the outset, is to consider whether in the event of additional liability becoming due, the taxpayer is likely to be able to fund it. In this event the taxpayer may wish to consider the possibility of a structured approach to bankruptcy under the auspices of a licensed Insolvency Practitioner. The time to do this, as noted above, is at the outset, when the taxpayer may have options available, not at the end when his back is firmly against the wall.

6. ADVERSITY AND THE TAX INVESTIGATION ITSELF

Necessary Distinctions

It is absolutely necessary to be clear as to the type of adversarial situation to which this part of this book relates. Generally there are three types of scenario between which we need to distinguish. In the first instance there is the situation where the taxpayer really is not prepared to cooperate for whatever reason. In circumstances like this we do our best to explain the consequences of falling foul of the System, and often as not the individual will be brought to realise that it is absolutely in his best interests to comply. In situations where that does not happen then lamentably the individual has to be left to his own devices, at least until realisation cuts in.

Next along is the individual with a laissez-faire approach, let them come to me and so on. A quick twenty minute chat is usually sufficient to bring these around. Finally there is the genuine adversarial situation where the actions of the individual Tax Inspector conducting the case are brought into question. Clearly it is this latter situation that we are considering.

In taking issue about the conduct of a case by a Tax Inspector, we must first be clear that the issues derive from the Tax Inspector and not obstruction or a laissez-faire approach on the part of the taxpayer.

The Usual Tax Investigation Scenario

Virtually all District Tax Investigations are started by enquiries instigated by HMRC, usually by way of a standard opening letter. There can be occasional exceptions to this. For example an individual may come forward and makes a voluntary disclosure

without having any reason to believe that HMRC are already aware of the subject matter of the disclosure. Such a case may lead on to deeper enquiries and a formal Tax Investigation.

The situation we generally discover when first called in is one where the Tax Investigation is still being worked by the Tax Inspector who has been permitted to take complete control, and there are issues with the conduct of the case. The Tax Inspector will have called for various papers and data, and the “inevitable” meeting will have occurred. Technically it can be argued that HMRC does not “automatically” have access to the private side of things but this frequently, in practice, is a technicality as there will almost inevitably be some reason why a consideration of these becomes necessary. The Tax Inspector will have had access to pretty much everything to do with the taxpayer’s financial life. He will have spent a significant amount of time working the case and may have formed opinions as to the likely outcome. He may be entrenched in his views.

Unfortunately his take on things may well be incorrect. Given however that he has examined many documents that the taxpayer’s accountant may not even have seen, he will have a detailed knowledge of the workings of the private side. In practice he will almost certainly be more familiar with the taxpayer’s private affairs than the accountant, and possibly even the taxpayer himself. This very definitely is not how Tax Investigations should be allowed to develop and we will shortly go on to discuss alternatives.

The usual situation when we arrive on the scene is that the Tax Inspector has taken control, and knows more about the financial matters of the taxpayer’s business, and possibly his private, life than the accountant and possibly the taxpayer himself.

Retrieving the Situation

We always work on the principle that revolves around the concept that, regardless the stage of the Tax Investigation, whilst the case is still being worked, the taxpayer should be given every opportunity to cooperate and make disclosure. This concept is completely in line with HMRC's stated policy. Our task is to facilitate this and ensure that it occurs, and it can be achieved by taking a step back and reviewing the case afresh.

I look at a Tax Investigation as something that “belongs” to the taxpayer who should be in full control of it. If that situation has deteriorated it must be retrieved and the role of the Tax Inspector adjusted to that of an employed individual assisting in the administration of the UK Tax System, and playing a part in facilitating closure.

For me this is fundamental in and completely critical to the successful outcome of a situation. As such I make absolutely no apology for the EMPHASIS THAT I HAVE PLACED ON IT HERE.

Tax Investigations belong to the taxpayer who should be in complete control of them. If that situation has deteriorated so that the Tax Inspector is in control it must be retrieved.

Before Moving On We Need to Define Types of Tax Investigation

As noted previously there are various categories of charge to duty - S/A, PAYE and CGT for example - and how these are investigated is at least in part determined by the perceived potential seriousness, the “Risk”, that HMRC anticipates as the duty potentially lost. I have grouped them into two categories, “less serious” and “more serious”.

Not particularly original descriptions I'm afraid but they fit the bill. Although Tax Investigations into each category of duty are technically different, essentially the same principles apply to each, and I have grouped the less serious together under the collective title "District Tax Investigations".

The more serious Tax Investigations, regardless the category of the duty, are grouped together by HMRC and investigated under what is described as Code of Practice 9 (COP9). The derivative of the method of treatment of this group, for those who have been around for some years, has its roots in the old "Hansard Procedure". Essentially they are cases where HMRC has considered a criminal prosecution and decided to proceed instead along the Civil Contract Settlement route. As noted previously, criminal prosecutions are not considered in this book. Prosecutions bring with them many ancillary issues and it would be wise to seek assistance from an organisation such as mine with facilities equipped to deal with them.

Tax Investigations are grouped here into two types, District Investigations and those conducted under COP9. Whilst the principles are fundamentally the same, operational procedures differ slightly.

7. DISTRICT TAX INVESTIGATIONS

Taking Control

This comment that we need to take control is not intended in a confrontational manner and, as I have mentioned before, it is HMRC's clearly stated policy to encourage the taxpayer to make disclosure. I see the taking of the control of the Tax Investigation by the accountant, and assisting the taxpayer to assimilate evidence as a natural part of the process of making disclosure. This approach is so very much better and avoids much if not all of the hassle involved in interchanges with HMRC.

Regardless the stage of the Tax Investigation, whether newly started or in a deteriorated situation, the overall approach is the same.

Newly Started Cases

When a newly started case is referred to me I write to HMRC, subject of course to the client's agreement, and that of his main agent, and explain that I am under instruction from the taxpayer to assist him to demonstrate the maximum possible cooperation. The most effective way of doing this (which indeed it genuinely is) is to undertake an assessment of the client's affairs myself and prepare a report for submission to HMRC undertaking to identify any areas of concern. In order to enable me to do this I shall be retaining the documents whilst I undertaken the work, and these will be submitted to HMRC at the time of completion of my review. Given that, in COP9 cases, the accountant is allocated a minimum of six months to complete a review, this is a reasonable time scale to apply here.

It takes a certain amount of confidence and may require a significant degree of firmness in dealing with the Tax Inspector, but can subsequently lead to a much smoother progression and a far less painful outcome for the client. If the Tax Inspector raises any

objections remember always that he is a junior Civil Service Manager with the job of doing nothing more than assisting with the administration of the UK Tax System. Whatever protests he may raise, his discretionary abilities are primarily restricted to the timing of penalties and procedures to require submission of documents.

Procedural penalties relating to the submission of documents may be threatened, but their intention is to encourage taxpayers to cooperate and have no place in a situation where the taxpayer is cooperating. If raised they are appealable, and the Tax Inspector may be made the subject of a complaint if they are raised unreasonably. We have offered HMRC a situation where the taxpayer is anxious to cooperate, has undertaken to do so, and has instructed us to assist in making a disclosure. How this develops is of course subject to the detail of the individual case, but we have yet to encounter a case where the Tax Inspector has sought to severely dispute our stance.

In a newly opened case take control from the outset and assist the taxpayer to cooperate. Do not be thwarted by threats of operational penalties which are intended only for situations where the taxpayer is not cooperating.

Ongoing Cases

The procedure here is essentially the same except that as the case has been running for a while, there may be more resistance from the Tax Inspector. Additionally it is almost inevitable that the timescales available for action may be significantly vexed. Each case must be treated on its individual merits. Always ensure that it is made clear that regardless past events the Taxpayer now wishes to demonstrate maximum cooperation and that you are seeking to assist him to make disclosure.

Procedural penalties relating to the submission of documents may be more difficult to resist and a judgement must be made of the merits

of living with these, versus permitting the Tax Inspector to have his head. This is just one of a number of areas where procedural judgements and decisions may become operationally more difficult.

The situation as regards the fact that the Tax Inspector's "status" is one of perception is unchanged but situations may be less clear cut generally than in opening cases.

Where cases have been running a while taking control may encounter more resistance from the Tax Inspector, and timescales available for action may be vexed. Each case must be treated on its individual merits.

Advantages of Taking Control

These are just a few of the advantages of taking control.

1. The pressure is taken off the client.
2. Harking back to the Tax Inspector's mindset consider that at any point in time he has an allocation of, say, forty cases or so to work. He is a human being under some degree of managerial pressure to progress them, and someone comes along and undertakes to do all the work on one of those cases for him? What would you say?
3. The action of aligning our responsibility for the Tax Investigation essentially adjacent to, or indeed ahead of, that of the Tax Inspector is of enormous benefit! We have previously seen that where the Tax Inspector is permitted to take control he will have examined many documents that the taxpayer's accountant will not have seen, and he will have a detailed knowledge of the workings of the private side so that in practice he will almost certainly be more familiar with

the taxpayer's private affairs than the accountant, and possibly even the taxpayer himself.

By taking control we completely reverse the previously described situation. We can now develop a substantial understanding of the private side, which almost inevitably is the side most open to attack. We will be submitting the data to the Tax Inspector and taking account of the inevitability of human nature and his additional work duties to what extent is he liable to work through our detailed report and take issue with any of the points when it, essentially, is a *fait accompli* for him to accept.

In circumstances where there has been an under declaration, an absolutely critical point to make is that in no circumstances should incorrect information be deliberately submitted to HMRC, nor should any information be withheld. I say this not in the sense that many accountants would deliberately set out to assist with fraudulent activities. They wouldn't per se, but on this occasion we must be aware of the potential consequences for us on this side of the fence as regards the influence of human nature. It may however be tempting to turn a blind eye to some piece of information that can be put to one side and not mentioned. In the first instance it places the accountant in a situation where he can be prosecuted. HMRC very properly take a very proactive approach to any accountant who behaves in such a manner. In this respect HMRC will find no argument from me.

The other aspect to this is that it does the taxpayer no favours either! In the first instance, as regards the future, it gives him the implicit green light that it is ok for him to continue whatever inappropriate activities have given rise to the current situation. Additionally the settlement is concluded on the basis that the taxpayer's affairs have been fully accounted for. If this situation is not correct and HMRC

become aware of additional impropriety then that additional impropriety will be severely treated.

4. As regards to the foregoing there is a complete difference between withholding information and the exercise of judgement. In my opening correspondence with HMRC I make it clear that the degree of cooperation demonstrated by the taxpayer will result in a substantial saving to the public purse. As such it is reasonable that judgement in any grey areas will be exercised in favour of the taxpayer, and I undertake to advise HMRC of any material circumstances where this has been done.

There are very significant advantages to taking control. The exercise of judgement in the taxpayers favour in grey areas may be completely acceptable but information should never be deliberately withheld from HMRC.

Issues with Taking Control

There is one disadvantage or even perhaps a problem for the “local accountant” in taking control and that is that he may be in a situation where he has to deal with the same Tax Inspector not just in relation to the case on hand, but on an ongoing basis. His inevitable concern must be that if he “upsets” a particular Tax Inspector there may perhaps be adverse consequences in the future when he again meets that Tax Inspector or even one of his colleagues on a different case. Word certainly tends to get around, certainly in this modern day of instantaneous communication. Many years ago when I was a “practice” accountant I tended even then to have difficult cases referred to me by other accountants because of my knowledge of the System. I recall phoning a tax office some sixty miles as the crow flies from my base location and on giving my name as Martyn Arthur, being asked “Is that the Mr. Arthur who does Tax Investigations”?

Technically there should be absolutely no question that an accountant will be in any way disadvantaged by anything that he has done in relation to separate cases and I would not dream of suggesting anything to the contrary. It is not my place to say more on this than to reflect that Tax Inspectors however are human beings, and subject to the same frailties as the rest of us fellow mortals.

Given human nature "local" accountants may be concerned that taking control in a particular case may adversely affect situations with the same Tax Inspector or his colleagues when dealing with other cases.

8. CODE OF PRACTICE 9 (COP9) TAX INVESTIGATIONS

The Nature of COP9

As noted this is the procedure which HMRC has decided to use in the “more serious” cases. In the first instance it is just that - a method which has been decided on by the management of HMRC, doubtless in consultation with other agencies, to process Tax Investigations of a perceived level of seriousness. It is not something that has its roots in statute.

The procedure itself stems from an earlier “Hansard” procedure, Hansard being Parliament’s official record of its daily proceedings. From memory I believe that the Hansard procedure came about when a Chancellor made a statement in the House of Commons about the principle of not prosecuting particular types of tax offenders. Hansard generally makes very dull reading and is not a recommended text for further reading.

The underlying concept of COP9 is that it offers the individual the opportunity to make a full disclosure of all irregularities, essentially, over the previous twenty years. The extent to which it is feasible to consider that timescale is not debated here.

COP9 provides that HMRC will approve the appointment of an accountant who will undertake all necessary research with a view to compiling a comprehensive Report of all improprieties committed by the taxpayer. The taxpayer both meets the cost of production of this report, and is also required to “adopt” it so that he becomes firmly responsible for it, and any omissions or understatements that it may contain.

The “reward” to the taxpayer is that, provided there are no material omissions from the report, then he is assured immunity from

prosecution in respect of all tax offences that have occurred to date. Any material omissions from the report may however be subject to prosecution if subsequently discovered.

COP9 is a Tax Investigation procedure applied to cases suspected by HMRC of being serious whereby, in return for making disclosure, the taxpayer may achieve immunity from prosecution.

HMRC's COP9 Leaflet

HMRC's guidance leaflet at <http://www.hmrc.gov.uk/leaflets/cop9-2009.htm> is, in terms of its factual presentation and content, generally well written and presented. By enlarge the COP9 procedures themselves are not unreasonable provided they are applied with common sense. As we saw in "**Similar Cases may be Subjected to Different Treatment by HMRC**", such cases can be treated with common sense, although this is not always the case. Given that the leaflet presents a reasoned explanation I can see absolutely no point in reinventing the wheel so to speak and I have therefore quoted quite extensively from HMRC's official leaflet whilst including my thoughts and comments. The sections enclosed in quotes are direct extracts from the leaflet. My comments are in bold italics.

"We [HMRC] will investigate any situation where we suspect serious tax fraud. The Tax Investigation will be undertaken with or without your voluntary co-operation."

"The Code of Practice covers direct taxes, including income taxes, Corporation Tax, Capital Gains Tax and National Insurance contributions and indirect taxes including VAT and Excise and Customs duties."

“The practice of HM Revenue & Customs (HMRC) in cases of suspected serious tax fraud is as follows:

- The Commissioners reserve complete discretion to pursue a criminal Tax Investigation with a view to prosecution where they consider it necessary and appropriate.
- Where a criminal Tax Investigation is not considered necessary or appropriate, the Commissioners may decide to investigate using the Civil Tax Investigation of Fraud procedure.
- Where the Commissioners decide to investigate using the Civil Tax Investigation of Fraud procedure they will not seek a prosecution for the tax fraud which is the subject of that Tax Investigation. The taxpayer will be given an opportunity to make a full and complete disclosure of all irregularities in their tax affairs.
- However, where materially false statements are made or materially false documents are provided with intent to deceive in the course of a civil Tax Investigation, the Commissioners may conduct a criminal Tax Investigation with a view to a prosecution of that conduct.”

“The Tax Investigation is **not** being conducted with a view to your prosecution for tax fraud.”

The reference to not being prosecuted in the COP9 leaflet is important as it is the taxpayer’s “immunity” from prosecution for Tax Offences and there are a couple of important points to make here.

- *Frequently the tax offences that are the subject of COP9 have implications for areas such as money laundering which can be prosecuted separately. I have had numbers of discussions with COP9 Tax Inspectors regarding the implications of this and the “behind the scenes situation”, but I have never had a fully satisfactory answer.*

My understanding is that the consideration whether to prosecute may have been undertaken in association with other agencies involved in law enforcement but that the immunity from prosecution very specifically does not extend to any other agencies.

- ***The immunity to prosecution does not extend to past tax offences which are not disclosed during the COP9 procedure.***

“We will ask you to a meeting and invite you to make a full disclosure of all tax irregularities. This will be your only opportunity to secure the maximum benefit from making a full and complete disclosure of all irregularities in your tax affairs. It is a matter for you to decide whether or not to attend and respond.”

My objection to attendance at meetings applies equally to COP9 cases, perhaps even more so, and non attendance does not disadvantage the taxpayer.

“You should give your professional adviser all the facts because you are personally responsible for your tax affairs and the accuracy of any information supplied to us.”

“We will not reveal to you the information we hold that has given rise to our concerns. This is because the aim of a Tax Investigation under this Code of Practice is to give **you** the opportunity to make a full and complete disclosure of all irregularities. The opportunity to make a disclosure extends to all aspects of your taxation affairs and encompasses any dealings you have had with partnerships, companies, trusts or other entities.”

“It is a matter for you to decide whether... or not to speak to us or assist us generally in our Tax Investigation....If you decide to

proceed, the next stage will be to ask you to respond ‘yes’ or ‘no’ to some formal questions.”

The formal COP9 questions can be dealt with in correspondence and do not need to be addressed verbally.

“We will invite you to provide a Disclosure Report, the nature of which will depend on the individual circumstances of the case. Areas to be covered in the report will be:

- a brief business history
- the nature of the irregularities and how they came about
- the extent of the irregularities
- steps taken to verify amounts with supporting documentation and any assumptions made
- a detailed schedule of the irregularities for each period involved for each tax

We will agree a timetable for producing this report at the meeting. In most cases we would expect the disclosure report to be submitted within six months of the opening meeting. The timetable will vary according to the complexity of the case and volume of work required, for example in more straightforward cases the report could be submitted considerably sooner.

It is our intention that we reach an agreement with you about how much is due and how much is to be paid, and when. We expect you to demonstrate a willingness to agree realistic proposals to make early payment of arrears.

We will invite you to make payments on account towards any tax arrears, both at the initial meeting, and throughout the enquiry. Payments on account will reduce any interest charges.”

I have previously addressed the fact that making a payment on account will have the effect of reducing the sum total of any overall settlement. Conversely a COP9 Tax Investigation will lead to a negotiated civil settlement and previously made comments about the potential usefulness of the availability of cash apply here also.

“Your disclosure report and subsequent returns must reflect the correct position. If we discover that the irregularities have continued during the course of the Tax Investigation this may result in criminal action in relation to what you have done since being given this Code of Practice, or a higher level of penalty.”

“It is your responsibility to ensure the Disclosure Report is accurate and complete to the best of your knowledge and belief. If you are satisfied that your report is a complete account, it should be signed by you as representing a full disclosure of irregularities, and submitted within the agreed timescale. We will ask you to certify that this is the case and we will not accept the report as your disclosure unless you do so.”

“Making a statement you know to be false may render you liable to prosecution.”

“Interest is calculated on any tax paid late. In some cases we could also charge you a surcharge.”

In respect of all Tax Investigations, COP9 or otherwise, Surcharges / penalties apply, essentially, to all cases where it has been demonstrated that there been an under declaration.

COP9 Cases Generally

The method of working of COP9 and District Cases is essentially similar and no further separate guidance is offered.

9. CONCLUSION

The main thrust of the book is directed at assisting others in understanding how to deal with adversarial aspects of the System that is HMRC. I originally leaned very heavily towards blaming individual Tax Inspectors and their perception of their status for many of the problems. I have not shifted from that significantly, but the process of authorship made me increasingly aware of the significant extent to which the System that is HMRC directs the conduct of the individuals within it.

In looking at the combined but different roles of the police and judicial system and then comparing them with the dual functionality of HMRC, we discovered the poignant story of HMRC's duplicity of function, which speaks very much for itself. Add to this the extent to which the conduct of HMRC is discretionary and that it has a regulatory system controlled entirely from within, and I will leave it to the reader to consider the extent to which there should be significant cause for concern.

Early iterations of the book contained numbers of real life examples drawn, in part, from past experiences. They also contained examples of more recent cases which could be vouched for by reference to current correspondence. However, as the reader has seen legal advice suggested that there was a very real possibility, regardless the authenticity of what I had written, that publication of the book could effectively be stopped. I truthfully believe that the book has a very real message which it is important that the public read, and the publication of which I do not wish to have stopped. I have therefore largely removed specifics and tended towards the use of hypothetical examples. The real life examples are still very much in existence however, and should, I believe, see the light of day sometime. That is a matter for the future, but perhaps not too distant a one.

Finally, if you have reached this part of the book I might reasonably assume that you have worked through the text that went before, and I

would like to thank you for taking the time to read what I have written. I will be very interested to receive constructive comments about the text, and ongoing developments will be recorded at my web site. My contact details at the time of going to press are, www.martynarthur.com, email martyn@martynarthur.com , or direct telephone numbers 07773 466093 / 07837 932658. Alternatively you can write to me c/o Ogmores by Sea Sub Post Office, 83 Main Rd., Ogmores by Sea, CF32 0PW. If these contact details have changed at the time you read this, you will doubtless be able to locate me by simply typing my name, Martyn Arthur, into any search engine.

APPENDIX 1: CPD DELIVERY

An organisation does not have to be a Registered CPD Provider in order to provide courses to ACCA members. As long as the learning and development activity that an ACCA member undertakes is relevant to either their current role or their career aspirations then it will constitute CPD. Members may calculate how much CPD they have gained on the basis of one hour of relevant learning activity equals one unit of CPD. In relation to this the ACCA has produced the following explanation, which can be related to CPD courses provided by Martyn Arthur.

Events may contribute to ACCA members' Continuing Professional Development requirements. ACCA's unit scheme requires members to indicate how their attendance helped to maintain or develop business and/or financial knowledge and skills relevant to their individual role and career aspirations.

If an event has contributed to members' development, and evidence of participation is kept, it will count as part of their verifiable CPD requirement. ACCA measures units by hours spent on a learning activity. For example, 6 hours = 6 units. For the avoidance of doubt ACCA has in no way quality assured any event provided directly by Martyn Arthur.

APPENDIX 2: KEY POINTS

The following is a summary of the key points made in the text. The Chapter and Section headings are also listed so that it is clear which part of the book the point came from.

1. OVERVIEW: THE SYSTEM IN CONTEXT

The Tax Inspector

Tax Inspectors are not demigods, human incarnations of the Norse God Thor able to strike us down at whim with a bolt of lightning. Within the System that is HMRC the Tax Inspector is simply a rank and file individual with no personal power or authority. He is a junior manager whose job it is to assist with the administration of the UK Tax System.

As a starting point, when considering and discussing “The” Tax Inspector, we are not considering in any way the Tax Inspector as a private individual, in his capacity as a human being, going about his private daily business. We are considering him very specifically within the cohesive whole “System” that is HMRC, and in the context of the manner in which he undertakes his work within that System.

Authority and Power

In the context of the Tax Investigations that are the subject of this book, HMRC’s powers are not wide ranging and are largely restricted to obtaining documents and to the instigation of a narrow band of penalty procedures. It is important to understand that authority is vested in HMRC, not individual Tax Inspectors, who simply have the discretion when to instigate procedures. The proposed quantum of any suggested adjustment and the instigation of penalties can be appealed, and

the timing of penalties can, if considered inappropriate, can be the subject of complaint.

The Opening of the Tax Investigation

Documents issued by HMRC in relation to Tax Investigations into potentially innocent taxpayers may open “we will investigate any situation where we suspect serious tax fraud. The investigation will be undertaken with or without your voluntary co-operation”. Clearly HMRC must be entitled to instigate enquiries, or even Tax Investigations, but the whole opening concept and approach may frequently be considered unreasonably heavy handed and inappropriate.

The Taxpayer, regardless his innocence, will almost inevitably incur substantial cost from the very start of the Tax Investigation, none of which will be repaid to him, regardless his innocence or guilt.

Examples of meetings that I had originally intended to use have been removed consequent upon legal advice received. I will be grateful to receive both positive and negative tales of Tax Investigation experiences that readers have encountered anonymously if preferred). Please email them to me, martyn@martynarthur.com or send by conventional mail to Martyn F, Arthur, C/O Ogmores By Sea Post Office, Main Rd CF32 0PW.

2. GENERAL POINTS

The Title of Tax Inspector

The use of the terms by HMRC of “clients” or “customers” for taxpayers is completely inappropriate.

The Target Audience

Intended originally, for a target audience of tax professionals and the self employed, this has been extended somewhat to bring balanced view of the shortcomings of the system to the attention of those within HMRC who are in a position to bring about essential changes in the system.

Human Aspects

This book focuses on aspects of the “human nature” side of Tax Investigations and interpersonal interactions.

3. THE SYSTEM THAT IS HMRC

Tax Inspector Recruitment Training and Reward

A Tax Inspector’s annual salary in London can approach £50,000. With the ability to arrange the working day within a system of flexible working hours, some thirty days annual paid leave and paid bank holiday absences, the Tax Inspector may be able to achieve some ten weeks or more paid absence from the office annually. His salary is not directly related to the financial value of Tax Settlements achieved.

Tax Inspector training is largely theoretical, offers little experience of the world outside the Civil Service and is delivered largely by HMRC staff who themselves may have been trained in a similar fashion to the new trainee.

The Mindset of the Tax Inspector

The Tax Inspector is a case worker, ensconced in a particular working environment, working cases as opposed to having a working relationship with individuals. This is not a criticism of the individual Tax Inspector who has little if any control of the

definition of his working environment. It does however enable us to understand why the behaviour of individuals may seem strange to us.

Differences and Issues at the Interface between Taxpayers, Accountants and HMRC

At the interface between Tax Inspectors and others, the mindset between the two is likely to be very different.

The lifestyle of the self employed revolves to a very great extent around work related concepts, for example the need to get new work in and keep existing customers happy and loyal. The Tax Inspector however is working a case, not engaging in a mutually reciprocal business relationship.

The failure of HMRC to adequately train its staff in the reality of working life can lead Tax Inspectors to views, conclusions and opinions that are substantially at odds with reality.

Tax Inspector Behaviour Regulation and Complaints

I have raised significant numbers of complaints over time in respect of a wide range of issues. Many of these have been referred to me by other accountants because they had been discontent with the action of individual Tax Inspectors. Not a single one of those complaints has been upheld! Did HMRC get it right every time, whilst we got it wrong every time?

HMRC is the most prolific revenue generating entity in the country, an organisation with a massive degree of discretion as to the treatment of taxpayers generally. Is it right that it administers its own complaints system (aside from very serious ones referred to the Independent Police Complaints Commission), and is responsible for the censure or otherwise of its staff?

4. ISSUES WITH HMRC

The General Treatment of Tax Fraud

The investigation of tax offences rarely results in a criminal prosecution and is generally concluded by a contractual civil settlement.

HMRC: Situations and Adversity

Significant parts of this book are about dealing with adversity and how to cope with situations where our perspective differs from that of the Tax Inspector. Actual examples that might have exemplified this have been omitted as a consequence of legal advice.

HMRC's Internal Disputes

Working within the requirements and parameters of the System, Tax Inspectors may fail to give appropriate consideration to all the factors of the case as we may perceive them.

Human Aspects Considered

From our perspective a decision making process should involve assimilating all the evidence and then coming to a decision. From an operational perspective, a Tax Inspector may take an overview of a case, reach a decision, and then invite the taxpayer to submit evidence to disprove that decision.

The case in this example started out very negatively for the taxpayer but careful examination of the facts has, at the time of writing, pushed the analysis of the balance marginally in his favour. This, along with associated "human" issues may well swing the argument fully in his favour.

A Compromise Solution to a Case similar to the Previous Example

The saving of a Tax Inspector's working time, and thus the consequential financial saving to the public purse, can result in a quid pro quo compromise settlement, in circumstances where a compromise settlement might otherwise not be feasible.

Briefly what the Issues within the System are

An underlying problem of the System, in so far as it relates to the control of tax abuse, is that it grotesquely underfunded and completely incorrectly structured. As a consequence the operational remit of individual Tax Inspectors and the System they help administer is intrinsically and inherently contradictory, to the significant disadvantage of taxpayers generally

There is a plenitude of examples of this, and I quickly arrived at twenty before deciding that this line was unlikely to represent what the reader wished to read. I restricted myself to just four points which briefly considered the contradiction of the role of the Tax Inspector as "independent" arbitrator and prosecutor.

5. CASES, ISSUES AND EXAMPLES

The General Nature of Tax Investigations

The taking, by the accountant, of responsibility for the case, is completely in keeping with the concept of enabling the taxpayer to demonstrate maximum cooperation. As a "bonus" it enables the taxpayer to benefit from maximum possible penalty remission for cooperation.

Working the Case

Evidence is not necessarily restricted to figures and the written word. Photographic evidence can be invaluable.

The need to look carefully at every angle is not restricted to issues associated with HMRC. Look inwards at the internal circumstances of the case.

A Cautionary Note for Tax and Accountancy Professionals

Avoid studiously the danger of becoming too involved with the taxpayer and the consequences for him of the Tax Investigation.

Unlike many solicitors we have a choice with whom to choose to work. It is the judgement of the individual Tax Professional who he chooses to work with. My advice is to steer very well clear of any case that potentially involves any form of "serious" criminal activity.

Recording Meetings and Telephone Conversations

Recording general conversations, meetings and telephone conversations can provide exceptionally useful data material. In the case of recordings of telephone conversations, where the third party has declined to consent to the release of the material, the existence of the data may still be constructively used.

HMRC's Internal Instructions

On Line Instructions published by HMRC are ostensibly suggestive of pretty compelling stuff! For us they are NOT in any way compelling. The on line instructions are essentially little more than HMRC's instructions to its staff on the conduct of their affairs.

The Burden of Proof and the Evidential and Shifting Issues

In relation to evidencing situations generally always remember that the burden of proof is the balance of probabilities and not an absolute one. Consider each case on its merits; is the Taxpayer's version of events most likely to be the accurate version? It can be difficult to "face off" a Tax Inspector but always remember that he is a salaried civil servant. You do not have to back down if he is intransigent and he cannot force closure against your will! The only entity that can require final closure is the appeal system or, exceptionally beyond that, the judicial one.

The Tax Inspector is unlikely to take a case to appeal that he has a very questionable chance of winning.

In the case of the evidential burden of proof, a Tax Inspector can be required to justify an assertion at appeal. It is reasonable to expect him to be able to do likewise throughout the negotiation and debate processes of the Tax Investigation itself!

Similar Cases may be Subjected to Different Treatment by HMRC

HMRC may argue that the circumstances of one case cannot be compared to another. This is true as far as the content of the cases is concerned. We are however entitled to expect that the principles governing the treatment of cases are consistent.

Payments on Account

Making a payment on account may inevitably result in a (slight) reduction in the overall interest payable in respect of a final settlement. Cash in hand however, must inevitably be an extremely useful bargaining tool in relation to settlements as a whole. Once a payment has been made it is no longer available to the negotiation process.

Precedents

When precedents are quoted, the situations to which they refer apply in situations where the circumstances of the case being quoted, are the same as the circumstances of the case under consideration. Always check carefully whether the circumstances of precedents quoted by HMRC are applicable, whether in full, or in part, to the case in question.

Affidavits and their Uses

Affidavits, sworn on oath, are potentially very persuasive as evidence. I am not aware of any formal precedents relating to their use but I have correspondence on file from HMRC establishing this as a principle.

HMRC is clearly on record as having accepted, in principle, that affidavits must be accepted as forming very persuasive arguments.

An Example of the Incorrect Application of Precedents and the use of Affidavits

We do not need accept the “rulings” of Tax Inspectors who very specifically do not have the last word.

Contracts Generally

In English and Welsh Law, with certain exceptions such as contracts relating to land, (the law in Scotland may be different) the terms of a contract can be written, spoken or even inferred. It may be possible that statements made by Tax Inspectors can be identified, by us, as forming part of any contract settlement to the client's advantage.

Cash Issues

Regardless that the Tax Inspector demands concrete evidence of a particular situation, for example cash transactions, the principle is always the same. Remember that the ultimate test is the balance of probabilities.

There is an almost if not entirely infinite gamut of permutations possible on the theme of verifying cash accumulations. The approach to take is to consider carefully the circumstances of the individual case, and to and identify possible forms of evidence that can be used to substantiate a situation.

The method of treatment of cash can vary enormously within different cultures. A precedent is created by reference to the specific circumstances of a particular case. If the culture of those involved in the creation of a precedent case is inherently different from that of the case under consideration this may have a significant effect on the applicability of the precedent.

Cash Flow Tests are appropriate in theory and in businesses where full formal records are maintained. In the world of the small trader their use must be viewed with considerable caution and their applicability challenged where appropriate.

Extrapolation

A proposal to extrapolate figures backwards, forwards or both should never be accepted unless it is certain that to do so would not disadvantage the taxpayer. Additional years, as necessary, should be examined by the accountant.

A Comparison of Living Style and Funds taken from a Business

The issues here have been discussed already under “cash” issues.

When a taxpayer's lifestyle and his ability to fund it is being considered by HMRC, the Tax Inspector may use an indicator such as the Family Expenditure Survey to endeavour to demonstrate a taxpayer's income needs. Any such comparison should be firmly resisted on the basis that it is totally hypothetical and is not in any way indicative of the taxpayer's real outgoings, lifestyle or income needs.

Profit Margins

Whatever the issue the answer is almost inevitably always there, somewhere, it's just a matter of finding it by having an open mind and looking at all aspects of the case!

Attempts by a Tax Inspector to attribute the difference between the normal, or average achieved by a particular industry, and the actual result achieved by a business to suppressed sales should be immediately refuted.

Wages

In circumstances where HMRC can demonstrate that suppressed sales have been used to pay wages a form of "circular" argument is created. By attesting that suppressed sales have been used to pay wages then it follows that those wages must actually have been paid and, as such, they are available to add onto the deductions in respect of the wages in the accounts. This can at least limit the damage largely to PAYE vat penalties and interest. If HMRC seeks to resist this due to the absence of records simply point out that by reference to the balance of probabilities they themselves have demonstrated that the wages were paid.

Attendance by the Taxpayer at Meetings

There is no requirement for the taxpayer to attend opening, or indeed any other, meetings and a refusal to do so does not

prevent a taxpayer from demonstrating cooperation in order to achieve penalty mitigation. If a decision is made by the accountant to attend a meeting the taxpayer should not be put in a position where he is subject to any unreasonable or unacceptable forms of questions.

Gearing and Capital Issues

Apart from Cash, which is addressed elsewhere, capital issues do not generally attract a great deal of attention and are not considered here.

Interest Charged by HMRC

The provision for the charge of interest is statutory. If however HMRC has occasioned any delays during the Tax Investigation seek to have the settlement figure reduced by the amount of the excess charge.

Penalties

Never simply accept HMRC's proposed penalty without being satisfied that the proposed figure is properly and reasonably calculated.

Exit Strategies if All Else Fails

Part of the holistic consideration of a case, from the outset, is to consider whether in the event of additional liability becoming due, the taxpayer is likely to be able to fund it. In this event the taxpayer may wish to consider the possibility of a structured approach to bankruptcy under the auspices of a licensed Insolvency Practitioner. The time to do this, as noted above, is at the outset, when the taxpayer may have options available, not at the end when his back is firmly against the wall.

6. ADVERSITY AND THE TAX INVESTIGATION ITSELF

Necessary Distinctions

In taking issue about the conduct of a case by a Tax Inspector, we must first be clear that the issues derive from the Tax Inspector and not obstruction or a laissez-faire approach on the part of the taxpayer.

The usual Tax Investigation Scenario

The usual situation when we arrive on the scene is that the Tax Inspector has taken control, and knows more about the financial matters of the taxpayer's business, and possibly his private, life than the accountant and possibly the taxpayer himself.

Retrieving the Situation

Tax Investigations belong to the taxpayer who should be in complete control of them. If that situation has deteriorated so that the Tax Inspector is in control it must be retrieved.

Before Moving On We Need to Define Types of Tax Investigation

Tax Investigations are grouped here into two types, District Investigations and those conducted under COP9. Whilst the principles are fundamentally the same, operational procedures differ slightly.

7. DISTRICT TAX INVESTIGATIONS

Taking Control

In a newly opened case take control from the outset and assist the taxpayer to cooperate. Do not be thwarted by threats of operational penalties which are intended only for situations where the taxpayer is not cooperating.

Where cases have been running a while taking control may encounter more resistance from the Tax Inspector, and timescales available for action may be vexed. Each case must be treated on its individual merits.

Advantages of Taking Control

There are very significant advantages to taking control. The exercise of judgement in the taxpayers favour in grey areas may be completely acceptable but information should never be deliberately withheld from HMRC.

Issues with Taking Control

Given human nature “local” accountants may be concerned that taking control in a particular case may adversely affect situations with the same Tax Inspector or his colleagues when dealing with other cases.

8. CODE OF PRACTICE 9 (COP9) TAX INVESTIGATIONS

The Nature of COP9

COP9 is a Tax Investigation procedure applied to cases suspected by HMRC of being serious whereby, in return for making disclosure, the taxpayer may achieve immunity from prosecution.

HMRC's COP9 Leaflet

The reference to not being prosecuted in the COP9 leaflet is important as it is the taxpayer's "immunity" from prosecution for Tax Offences and there are a couple of important points to make here.

- *Frequently the tax offences that are the subject of COP9 have implications for areas such as money laundering which can be prosecuted separately. I have had numbers of discussions with COP9 Tax Inspectors regarding the implications of this and the "behind the scenes situation", but I have never had a fully satisfactory answer.*

My understanding is that the consideration whether to prosecute may have been undertaken in association with other agencies involved in law enforcement but that the immunity from prosecution very specifically does not extend to any other agencies.

- *The immunity to prosecution does not extend to past tax offences which are not disclosed during the COP9 procedure.*

My objection to attendance at meetings applies equally to COP9 cases, perhaps even more so, and non attendance does not disadvantage the taxpayer.

The formal COP9 questions can be dealt with in correspondence and do not need to be addressed verbally.

I have previously addressed the fact that making a payment on account will have the effect of reducing the sum total of any overall settlement. Conversely a COP9 Tax Investigation will lead to a negotiated civil settlement and previously made comments about the potential usefulness of the availability of cash apply here also.

In respect of all Tax Investigations COP9 or otherwise, Surcharges / penalties apply, essentially, to all cases where it has been demonstrated that there been an under declaration.

COP9 Cases generally

The method of working of COP9 and District Cases is essentially similar and no further separate guidance is offered.