

# Review of HMRC Powers: Update.

*As part of the review of HMRC's powers, deterrents and safeguards, three further consultation papers were published on 10 January 2008. The stated aim of the review is to develop a modern framework of law and practice for HMRC, and to strike a balance between the statutory powers which HMRC requires and the rights of and necessary safeguards for the taxpayer.*

*The implications of the consultations are widespread and apply to taxpayers at both an individual and a business level. Of particular interest and perhaps concern is the widening of HMRC's information gathering powers envisaged in the consultation paper "A New Approach to Compliance Checks".*

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## A New Approach to Compliance Checks

Building on the proposals in and responses to the original May 2007 consultation, this latest consultation proposes, in some more detail, "a new approach to compliance checks." The consultation defines a compliance check as "all that HMRC does to ensure that taxpayers declare the right amount of tax" and, *inter alia*, deals with record-keeping, information gathering powers and enquiries. The overall intention is to replace the existing HMRC powers in this area with an entirely new framework which will apply across the tax regime, so ensuring a consistent approach wherever possible and enabling the powers to be updated where necessary. The changes will not come into effect before April 2009.

Note that the consultation does not deal with criminal investigations which were dealt with in legislation in the Finance Act 2007.

### **The Framework: Calculating the Risks**

In line with HMRC's recent approach in other arenas, the consultation emphasises that HMRC intend to take a "risk based approach" to compliance checks, and that they will respond differently to persons underpaying tax as a result of an "innocent mistake" as compared with those who have acted deliberately and/or taken action to conceal their activities. Although the emphasis in the framework is on encouraging voluntary compliance, perhaps unsurprisingly the majority of the consultation

document deals with the formal powers which HMRC may use in cases of non-compliance.

## **Keeping Track**

In relation to record-keeping, HMRC propose maintaining a generic record-keeping requirement in relation to all taxes in the primary legislation. A detailed list-based approach has been rejected on the basis that producing such an exhaustive list would be difficult and moreover would unnecessarily increase the compliance burden by removing a taxpayer's discretion to keep only records relevant to it. The draft primary legislation and commentary in relation to record keeping (and information gathering powers which are discussed below) are available on the HMRC website and can be accessed by clicking [here](#).

The primary legislation will be supplemented by secondary or tertiary legislation where necessary (for example in relation to PAYE, NICs and VAT, where the taxpayer is effectively carrying out a collection function on behalf of the state, or where more detailed records are required under EU law), and more importantly by non-statutory guidance which will set out tailored, practical suggestions of how the legislative requirements can be met.

On the time limits applicable to record retention, it is suggested that despite the current discrepancies between the different tax regimes, alignment is unlikely to have a significant beneficial effect and therefore is not proposed. However HMRC do suggest that the current facility under which a taxpayer can request a shorter time limit to apply to VAT records should be extended to direct tax records.

Finally, HMRC accept that future legislation will need to recognise that it is not always necessary for records to be kept in paper format and propose that this is done by way of regulation.

As currently, failure to comply with the statutory record keeping requirements may result in penalties, and it is proposed that such penalties will now be aligned across the taxes.

## **Information Gathering Powers**

The section of the consultation paper on information gathering powers is perhaps the most interesting and that most likely to provoke debate. It is proposed that HMRC's existing information gathering powers be repealed and replaced by a new regime, the key features of which are outlined below:

- HMRC would have a power to require the production of business tax records required to be kept by law, and to inspect business assets and business premises by prior arrangement. Any request would need to be "reasonable" and would be governed by a Code of Practice. Although HMRC currently have the power to review VAT and PAYE records at business premises, and to inspect premises under the VAT legislation, it

is a significant extension of their powers to permit asset and premises inspection in the direct tax field. HMRC justify this by outlining a number of advantages for both taxpayers and themselves, including the faster resolution of issues and the possibility of cross-checking records against actual assets. Moreover, they consider that voluntary at-premises inspections of records are already regarded as “good practice” by many compliant taxpayers, and the norm throughout OECD countries.

Significantly, there would be no right of appeal against this power, however HMRC consider this is in line with the powers of other regulatory bodies who have an absolute right to ensure that legal obligations are complied with.

It is further proposed that HMRC should be allowed to exercise this power before the relevant returns are submitted in relation to all taxes. Although the power would only be available pre-return in respect of direct tax in certain specified circumstances, these circumstances are widely defined and include, for example, where necessary to confirm that appropriate records are being kept and to check current actions which are relevant to a tax avoidance scheme.

- In certain circumstances HMRC consider that they may also need the right to make unannounced visits to business premises, for example where there is a risk that the taxpayer may remove assets or alter business records if they are given advance notice. Despite representations in relation to the May 2007 consultation, HMRC do not consider that it is practical or cost-effective to impose an external authorisation requirement on such visits, however they do propose introducing an internal authorisation requirement as a taxpayer safeguard.
- HMRC would also have a power to require the production of any non-business tax records required to be kept by law (e.g. those kept by an individual relating to their own individual tax affairs). Again, any request under this power would need to be “reasonable”, including as to when and where the documents would need to be produced, and a Code of Practice will be developed to provide guidance in this area. As in relation to business records, HMRC do not consider that taxpayers should be given a right of appeal in respect of such a request. The power in respect of non-business tax records would only be applicable after the end of the relevant year or assessment and there would be no right to visit or inspect a taxpayer’s home.
- In relation to “supplementary information” (i.e. information which is not strictly required to be maintained by law, for example because the information falls outside the statutory requirements or because the relevant statutory time limits have expired), HMRC propose a power to require production from a first party where reasonable and potentially relevant to establishing the tax liability of the taxpayer. This power would apply to both business and non-business taxpayers. As a new taxpayer

safeguard, there would be a right of appeal against the exercise of such a power (which is not always currently available) unless HMRC, exceptionally, obtain pre-authorisation from the appeals tribunal.

- HMRC would also have a power to require third parties to provide information in two circumstances (i) as currently and more commonly, with pre-authorisation from the appeals tribunal (which will only be sought by HMRC when a senior HMRC officer considers that the information request is necessary and proportionate), or (ii) under a new provision, where the taxpayer agrees in writing that HMRC may approach the third party.

Penalties may be charged (subject to a right of appeal) for a failure to comply with HMRC's information gathering powers. HMRC envisage that in a small number of cases where there is a deliberately non-compliant taxpayer they may apply to the appeals tribunal to request that an "appropriate and proportionate" penalty not capped by statute be imposed.

### **Time Limits**

The proposed amendments to the time limits applicable to assessments and taxpayer claims is the area which perhaps most clearly demonstrates HMRC's determination to support those who make "innocent mistakes", whilst coming down hard on those who deliberately fail to comply. Broadly, the proposal is that the time limitation periods for all taxes will be aligned. The normal assessment period will be four years (instead of the current limits of three years in relation to VAT and six years for other taxes), and this time limit will apply to VAT assessment periods, discovery assessments, and error or mistake claims. A six year time limit will apply to tax lost as a result of a failure to take reasonable care (i.e. negligence), whilst a 20 year time limit will apply to tax lost as a result of deliberate understatement (i.e. fraud), failure to notify liability and or an undisclosed avoidance scheme. Note that HMRC consider that further work will be required in this area in order to analyse the effect of the proposals on taxpayers and the Exchequer.

Following feedback from respondents to the May 2007 consultation, it is proposed that the safeguards offered by a 12 month enquiry window into self-assessment and corporation tax self-assessment returns will be retained. However HMRC have rejected proposals that the VAT "evidence of facts" rule and the two year VAT rule should be incorporated into the direct tax system and consequently they will remain applicable to VAT only.

After an enquiry window has closed, under current law HMRC have the power to make a discovery assessment, however that power would be repealed under these proposals. Instead it is proposed that HMRC should be allowed to use the information powers outlined above, subject to a number of additional safeguards for taxpayers. It appears that there will be some further work in this area.

More generally, in relation to the operation of an enquiry, the consultation paper sets out a number of possible reforms. These include, for example, a right for HMRC to correct an obvious error on a return (subject to taxpayer approval) and a recognition that greater training and guidance should be given to enable HMRC officers to focus on the most high risk areas.

## Other Consultations

As noted above, two other consultation documents forming part of the programme of work on modernising HMRC powers have also been published.

The first, [Penalties Reform: The Next Stage](#), proposes the extension of the penalties regime introduced in FA 2007 with minor amendments beyond the five main taxes to cover, for examples, SDLT, stamp duty and inheritance tax. It also proposes a new regime for penalties in relation to the failure to notify HMRC of a new taxable activity.

The second, on [Payments, Repayments and Debt](#) expands on four of the suggestions made in the June 2007 consultation document of the same name, namely (i) removing inconsistencies in HMRC's current enforcement powers; (ii) allowing the principle of set-off to be extended across the whole range of debts administered by HMRC; (iii) enabling taxpayers to pay with a credit card; and (iv) enabling HMRC to recover all small debts it is owed through the PAYE system. The controversial suggestion included in the June 2007 consultation paper that HMRC's current powers of distraint for unpaid debts be extended to include the direct attachment of assets, is apparently being looked at further by HMRC in the light of the responses it received to that document.

## Conclusions

Overall, the consultation documents propose quite fundamental reforms. However, perhaps most striking is the amount of detail that will be the subject of guidance (for example, the detail about what records HMRC would expect a taxpayer to keep) or contained in a Code of Practice (for example, the detail about when it is "reasonable" for HMRC to exercise its information gathering powers, or powers to access business assets or premises) rather than the legislation.

Amsterdam  
Linklaters LLP  
World Trade Centre Amsterdam  
Zuidplein 180  
1077 XV Amsterdam  
Tel: (+31) 20 799 6200  
Fax: (+31) 20 799 6300

Brussels  
Linklaters LLP  
Rue Brederode 13  
B - 1000 Brussels  
Tel: (+32) 2 501 94 11  
Fax: (+32) 2 501 94 94

Frankfurt am Main  
Linklaters LLP  
Mainzer Landstraße 16  
60325 Frankfurt am Main  
Postfach 17 01 11  
60075 Frankfurt am Main  
Tel: (+49) 69 71003-0  
Fax: (+49) 69 71003-333

Lisbon  
Linklaters LLP  
Avenida Fontes Pereira de Melo, 14-15º  
1050-121 Lisbon, Portugal  
Tel: (+351) 21 864 00 00  
Fax: (+351) 21 864 00 01

London  
Linklaters LLP  
One Silk Street  
London EC2Y 8HQ  
Tel: (+44) 20 7456 2000  
Fax: (+44) 20 7456 2222

Luxembourg  
Linklaters LLP  
35 Avenue John F. Kennedy  
P.O. Box 1107  
L-1011 Luxembourg  
Tel: (+352) 26 08 1  
Fax: (+352) 26 08 88 88

Madrid  
Linklaters, S.L.  
Calle Zurbarán, 28  
E-28010 Madrid  
Tel: (+34) 91 399 60 00  
Fax: (+34) 91 399 60 01

Munich  
Linklaters LLP  
Prinzregentenplatz 10  
81675 München  
Postfach 80 15 20  
81615 München  
Tel: (+49) 89 41808-0  
Fax: (+49) 89 41808-100

New York  
Linklaters LLP  
1345 Avenue of the Americas  
New York, NY 10105  
Tel: (+1) 212 903 9000  
Fax: (+1) 212 903 9100

Paris  
Linklaters LLP  
25 rue de Marignan  
75008 Paris  
Tel: (+33) 1 56 43 56 43  
Fax: (+33) 1 43 59 41 96

Stockholm  
Linklaters Advokatbyrå AB  
Regeringsgatan 67  
Box 7833  
103 98 Stockholm  
Tel: (+46) 8 665 66 00  
Fax: (+46) 8 667 68 83

Taxpayers will obviously be concerned to ensure that their positions are protected going forward. In this regard, the consultation on HMRC internal appeals procedures (published on 9 October 2007 as part of the Pre-Budget Report), the draft Code of Practice contained in the consultation on a new approach to compliance checks and the development of a "Taxpayers' Charter" (**announced** by Jane Kennedy, the Financial Secretary to the Treasury, on 10 January 2008) are all likely to be relevant. However guidance and other non-statutory materials can only ever be of limited value, and the key will therefore be to ensure that appropriate checks and balances on HMRC's powers are contained in the legislation.

*If you require further information or comment, please contact Mike Hardwick tel: +44 20 7456 5658 or your usual Linklaters LLP tax contact.*

Editor: **Mike Hardwick** Email: [michael.hardwick@linklaters.com](mailto:michael.hardwick@linklaters.com)

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