

# Tax records going digital

Jesminara Rahman explains how tax going digital will have an impact on the records that HMRC can request

By April 2022, all VAT registered entities will be required to follow the Making Tax Digital (MTD) rules by keeping digital records and using software to submit their VAT returns. Tax legislation requires that the software must have a live digital link to submit the returns to HMRC.

Self-employed businesses and landlords with annual business or property income above £10,000 will need to follow the rules for MTD for Income Tax from their next accounting period starting on or after 6 April 2023.

The government is looking to Making Tax Digital for Corporation Tax, but this will not become compulsory before 2026.

Taxpayers will be required to keep electronic records, but if all electronic records are kept on the software does this mean HMRC has the right to access the accountancy software? In order to understand the impact of electronic records, we need to understand what records are HMRC entitled to request in the first place.

## Statutory records

HMRC have the right to request statutory records, which cover any records used to make a complete and accurate tax return, declaration or claim, this would typically cover and is not limited to business bank statements, sales and purchase invoices etc..

HMRC may make informal requests for information and document which is not legally enforceable. In *Long v Revenue and Customs* 2014 UKFTT 199, the tribunal judge ruled that the doctor's appointment diary was not reasonably required and therefore not legally enforceable. On the other hand, HMRC can request personal bank statements if it has been used to carry out business transactions as this would make it part of the business records.

However, if there are no business transactions carried out in the personal bank statements then HMRC would have to provide robust reasons for the requesting personal bank statements when it is not connected to the business. Recently, Tax Resolute carried out a poll where 29% of the voters responded that they would provide whatever information and documents that HMRC would require.

Each request from HMRC should be considered on the grounds of whether it is reasonably required to check the accuracy of the tax return that HMRC are checking and should not be automatically provided to HMRC.

A formal HMRC request for information and documents are legally enforceable if HMRC issues a formal notice under Schedule 36 Finance Act 2008, which can lead to penalties being imposed for non-compliance.

## Electronic records

HMRC will specify the format of the documents and request electronic records where it has been held digitally. In HMRC's compliance handbook (CH214000) - How to do a compliance check: records: electronic documents and records, HMRC states they can seek access to computerised records, which can lead HMRC to check computers or associated devices.

This power allows in HMRC's view to potentially access computers as well as copy the information held on them by an HMRC authorised officer who has the training to access computer records. This includes access to the device on which the electronic data or individual documents are stored, for example:

- internal or external hard drives containing backed up information/scans of paper documents.
  - CDs or DVDs.
  - memory sticks or cards.
  - record-keeping apps on smart phones or tablets.
- Examples of devices considered to be computers, include:
- modern constant memory tills and other Point of Sale (POS) systems.
  - smart phones.
  - tablets.

HMRC are requesting in their compliance checks or tax investigations specifically for records that are held in electronic format, but it is not necessary to provide HMRC access to the actual devices on which the records have been held. In one case, HMRC wanted to make an onsite visit to our client's premises, which was a travel agency and access the computer

software directly. This request was refused because it was a live customised software that was in constant use and the client could not afford to give HMRC unrestricted access.

However, electronic extracts of the records held on the software was provided to HMRC, which enabled HMRC to check the accuracy of the figures submitted in the tax return.

### HMRC access to electronic records

HMRC tends to follow these steps in requesting electronic records and access to the accountancy software. This is a real-life example from a case.

**Step 1** - The request below by HMRC can often be seen in the first informal request for information and documents:

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Where documents are held in an electronic format, please provide them electronically

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**Step 2** - HMRC have changed their approach in recent compliance checks, where the HMRC officer states:

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I have sent an E Mail to the Systems and Data Compliance team to contact you to discuss the accountancy package your client is using Quickbooks online for the records that are required from this system, they will contact you in the next five working days. After they have contacted you and received the records, they will notify me and I will call again to arrange a date for an officer to call you. Please click here for Dropbox Link

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**Step 3a** - The authorised HMRC officer will then contact the agent or taxpayer and actually request accountant's access to the software.

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I require some records from your QuickBooks Online accounting system in order to carry out some basic checks on the VAT records for your client. If you grant me accountant access to your Quickbooks online accounting software I will be able to run all the reports and ensure they are in the correct format for us to use. I will not change any data on your system, and I will provide a copy of the audit log to show that nothing has been changed. Once I have the information I require, I will inform you and ask you to remove my access.

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**Step 3b** HMRC should state an alternative option to provide the electronic records if the taxpayer or agent is not happy to provide direct access to the accountancy software as HMRC did in this case.

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If I am unable to access your system in this way, I will need to send you the detailed instructions to run the reports we require. These will need to be followed exactly in order for us to obtain useable data from your system.

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### Digitalised compliance checks

HMRC resources have been decimated by office closures, the pandemic and even Brexit, as many HMRC officers were reallocated to work on Brexit. It does make sense that HMRC seek ways to work their compliance checks remotely from their desktop by reviewing electronic records. Records can now be held in electronic format and exported on a shared Dropbox link with HMRC. Any records sent to HMRC are sent to a centralised post centre, where it is scanned in and forwarded via the case management system to the caseworker. The days of posting paper records are becoming a memory of the past. Even then paper records can be scanned and held electronically. HMRC are moving towards tax becoming a digital system, which also means managing digital records for the taxpayer and HMRC.

However, this does not mean that HMRC should have direct access to the accountancy software. This would give HMRC access to records that maybe irrelevant or confidential therefore out of the remit for HMRC to check. It's important that as agents that we safeguard our client's rights including HMRC's access to the records and minimise the costs to our client.

HMRC will request information and documents that may not be legally be enforceable. Some taxpayers/agents are under the impression that whatever HMRC requests will be supported by legal grounds, but this is not always the case. HMRC will make informal requests that may not be supported by tax legislation and therefore cannot be followed up by HMRC with a legal information notice.

The keyword in considering HMRC's request for information and documents is reasonably required, for example HMRC should not be requesting for private bank statements of the other individuals not connected to the company during a company compliance check.

The taxpayer is in a position to provide records in an electronic format downloaded from the accountancy software and it is not necessary to provide HMRC direct accountant's access to the software. HMRC are looking to access accountancy software directly and even have specialised teams established to handle the process of accessing the software. It will be interesting to see the future development of digital tax records as there is a grey area between records held electronically on the accountancy software and the accountancy software itself. The distinction between the two will be explored and challenged by the taxpayer and HMRC going forwards. I look forward to the challenges it may bring.

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