

COP9 case study – part two

This is the second part of a three-part series by Anton Lane considering how a COP9 disclosure may unfold. The final instalment will be in our next issue

In part one of the case study, Scott had received a letter from HMRC enclosing code of practice 9 (COP9). Scott accepted he had deliberate acts resulting in tax liabilities and unlike some, he didn't try second guessing what HMRC knew. He rightfully assumed it was highly likely they just knew.

Scott had tax irregularities relating his property portfolio, suppressed business income, undeclared benefits in kind, unlawful dividends, and the motorsports team had been funded by the business. It was likely other areas would be identified as primary records were reviewed.

The initial meeting came to a close with HMRC requesting whether Scott would be making a payment on account. Scott was prepared for this question and whilst liabilities were not quantified, we knew the amount of turnover that had been suppressed and also an estimated amount of property income received. A payment on account was offered by Scott, which was of a size to demonstrate the resolve to regularise his affairs. We knew the tax liability would be higher than the payment on account but ultimately the liability agreed would depend on how successful negotiations would be. We therefore didn't want Scott to pay too much.

Often it is difficult for a client to make payments on account either because they have invested funds or the tax not paid has been spent. HMRC won't necessarily see the inability to make a payment on account as demonstrating a lack of cooperation. However, if you recall HMRC did take a dim view of Mr B choosing not to make payments on account and instead accumulating a few investment properties during the disclosure process.

Scott was concerned with whether he had disclosed everything and whether he would face prosecution if something came to light later. As an adviser who has dealt with COP9 for over two decades, you always wonder whether a client has told you everything. This suspicion arises from experience. Most clients remember something that gives rise to a tax liability sometime after the initial meeting.

For example, Mr B, an accountant had yet to be issued with COP9. He had been paying rent for two offices. The second office according to the accountant was looked after by a large commercial landlord. HMRC had challenged the deductibility of the expense and Mr B provided HMRC with the landlord's details. HMRC pointed out to Mr B that the property was a residential property. Undeterred by HMRC, Mr B confirmed that he let the front room of the house as an office. HMRC issued COP9 and Mr B made an initial disclosure. Mr B, however, failed to inform HMRC that the self-employed bookkeeper he retained had returned to live in Poland a few years before and the amounts drawn from the bank were not in fact sums drawn to pay the bookkeeper, but funds drawn to pay his ex-wife. These circumstances would normally provide enough grounds for HMRC to prosecute although in this case, HMRC sought higher penalties. HMRC also cited the acquisition of several buy to let properties during the disclosure rather than making payments on account as grounds for not considering a payment arrangement.

If the risk of prosecution is to be avoided and penalties mitigated as best as can be, it is essential to identify all material irregularities and it is helpful to know what HMRC are concerned with. It would be less frustrating if HMRC were to simply tell but that does not embrace the principle of COP9: for the taxpayer to honestly tell HMRC of all deliberate acts resulting in material omissions. A tax investigations specialist and a HMRC officer will often arrange to hold a 'scoping meeting'.

The purpose of a scoping meeting is to agree the areas reviewed and to be covered by the disclosure report. The HMRC officer won't tell the agent the areas of concern. A scoping meeting may result in the prioritisation of the areas already disclosed as well as agreeing the period of review. An officer may indicate that HMRC would prefer the review to analyse transactions (or bank statements) for a period, which would

indicate they may not have concerns for years prior to that period. It would be foolish to assume HMRC want less than the statutory twenty years considered so any shorter period needs to be agreed. The disclosure report should also set out the scope of the review undertaken.

One case where COP9 was requested to afford our client protection, only appeared to have tax irregularities from the point that the Mr C had promoted a particular solution to clients. The solution was one that purported to offer significant employer savings although appeared to actually be a fabricated planning arrangement where PAYE was never paid over to HMRC. The National Crime Agency seized bank accounts and HMRC applied to the court to wind up various companies. Our client therefore looked to set up his own similar arrangement. Following seeking VAT advice which stated VAT was due, Mr C did not charge VAT.

A collaborative HMRC officer will also give clear indications of the areas that need covering by the disclosure report. Knowing the areas which an officer desires to be included, can often lead an adviser to know what taxes are affected.

The scoping meeting held in Scott's case did not immediately follow the initial meeting, which often happens – the client leaves and the agent remains with HMRC. Instead, we set the scoping meeting up for a couple weeks after the initial meeting. For this meeting, we visited HMRC's offices. The meeting was before the regional offices were established so lacked the slightly better beverages you now get.

A HMRC officer should be comforted when a tax investigation specialist is involved with a disclosure under COP9. If the agent has little experience or is a general accountant or tax adviser, the officer may less comfortable. A specialist should know the process and provide services to a standard that make agreeing the settlement of a case easier. Not all cases are easy to settle although if a thorough job has been done, the officer will have minimal questions and areas for negotiations will be pre-empted and solutions prepared. We recently engaged an offshore entity that was being enquired into where, in our view, the previous acting agent may not have helped the client:

'Please find attached a copy of Comp1a, which has also been sent by post. We have recently been appointed to assist our client with your enquiries. We note your last letter to our client was dated X April 20XX and requested a response by 9 May. We understand that our client has requested an extension to respond, and it was agreed this would be by 31 May.

You will appreciate HMRC's request spans a considerable period and are not limited to [The Company]. All the requests made in the letter dated 7 April do not actually relate to [The Company].

We also note that on X February 20XX, HMRC issued a schedule 36 notice followed with a penalty notice on XX April 20XX. We are concerned with the validity of that notice in particular:

- *There are concerns over the reasonableness of the information requested,*
- *The notice is issued to [The Company] and several requests do not relate to that company,*
- *The documents requested cover a very substantial period and the officer preparing the notice would have needed to consider the constraints of FA 2008 Sch 36 p20 and would presumably have adhered to the internal sign off requirements documented at CH22140, CH21720 and CH260500. We kindly request confirmation and evidence thereof.*
- *The requests arguably require a speculative response.*

We are meeting with our client on XX June and will be taking the opportunity to review available records. We would suggest that once we have familiarised ourselves with our clients' affairs, we contact you to agree the appropriate way forward. We would anticipate this to be no later than 30 June. We trust you will be agreeable to this approach.'

In Scott's case the scoping meeting was short although very useful. It was clear the officer was concerned whether the Company should be able to offset the expense of the motorsports team against taxable profits. The officer was also concerned about employee expenses, the property portfolio and whether occupants were connected. Other areas mentioned were benefits in kind and other investments held,

which are normally always raised. From this meeting, we had our areas of focus, which didn't appear to be extensive. However, the period to be considered started with the 2000/01 tax year through to 2015/16.

The officer also raised whether there would be ongoing payments on account suggesting the liability could be considerable. The officer had evidently identified the potential liabilities that could arise from the denial of the motorsport expenses. We agreed with the officer that we would revert to our client and seek to make a further payment on account when we had a better perspective on the potential liabilities. We agreed we would discuss payments on account at our subsequent update call.

HMRC had strongly indicated that the records they had been provided, which were limited, were not reliable in their view and a forensic exercise would be required to build accounts for the entire period. Fortunately, the client's newly appointed accountant confirmed that they could assist prepare the accounts in conjunction with us considering the adjustments required from a tax perspective. This appeared a reasonable approach and would potentially save us a considerable amount of work. We agreed this approach in October with the aim of completing the accounts by the following 31 March. An interim progress meeting was scheduled for the 1 March. Given the quantum of work to prepare accounts, HMRC suggested regular update calls with a meeting at the beginning of March to ensure we were on track for a submission of the disclosure report in April. The HMRC officer accepted that there may have to be some wiggle room on the timing of the disclosure report.

Given the accountant was reviewing primary records including bank statements, invoices, receipts, employee expense claim (including those by directors) and handwritten bookkeeping books, our work concentrated on the preparation of the disclosure report.

A disclosure report is not just an analysis of the undeclared tax liabilities. A disclosure report is also the opportunity to present relevant facts to HMRC that may have an impact on the tax liabilities and also penalties.

We prepared a disclosure for a client where he and his spouse had lost their first child. Following the daughter's premature birth, being kept in hospital for nine months and being released from hospital to live at home, she passed away only a few months later. The wife became pregnant again but what followed was a devastating history of illness. Following the birth of her second child, the wife was diagnosed with leukaemia. The treatment killed white blood cells resulting in a vulnerable immune system. Our client's wife spent the first part of her children's lives in isolation. Eventually a bone marrow donor was identified, and a stem cell transplant operation performed. The wife was released from hospital only to fall ill a short time after. It transpired that the donor had suffered chicken pox and the spouse had not. The virus had effectively been placed into the wife through the transplant operation. The wife was induced into a coma to permit anti-biotics to be administered and for the infection to be fought. However, when released from the coma, the wife was paralysed from the neck down.

During the first few years of these terrible events, the husband implemented tax planning arrangements using offshore structures. Advice was provided on the establishment of the structures, but no ongoing advice provided. Inevitably, transactions had consequences that went unreported. The client however had a 'reasonable excuse'. The client suffered sleep deprivation and anxiety and as a result was not mindful of the tax position. The act could not be deliberate, and the client had a reasonable excuse.

Scott had no circumstances affecting the liabilities arising over the 15 years. There was reliance on a professional adviser, and it could be established that the adviser had misled Scott that returns had been submitted. However, it was going to be difficult to successfully argue that Scott had been misled for the entire fifteen years. It was likely that HMRC may believe that accepting non-compliance for a long period suited Scott. However, carefully explaining the background could help with penalty negotiations.

Earlier I mentioned an offshore entity that had engaged us. The previous agent had provided HMRC with what the adviser referred to as a 'disclosure'. The disclosure consisted of eight pages that broadly answered some but not all the questions previously raised by HMRC and seven hundred pages of redacted

information. It was clear the agent had not thought through why HMRC were asking for information and had not presented the information in manner to bring the enquiries to a close. No consideration had been given to what HMRC would contest. The disclosure did not prepare a defence against what HMRC would potentially contest. No facts that could mitigate penalties were set out.

An important part of the work to prepare the disclosure report includes detailing the background to the disclosure, personal history and business history. Each of these can impact on establishing deliberate or non-deliberate behaviour as well as identify reasons why penalties should be mitigated.

To prepare Scott's disclosure required fifteen years of accounts being reconstructed. The accountant had agreed to undertake this task although by the end of February, they had only managed to prepare one year. This was a significant problem, and an interim progress meeting was imminent. Specialist tax investigation firms are aware of the importance reconstructing accounts and turn normally to primary records such as bank statements. It was important to inform the HMRC officer that additional time may be required to reconstruct accounts. However, it is also important to demonstrate progress and keep ongoing communications with HMRC on progress. On this occasion, we took back the reconstruction of accounts and agreed with the officer to cancel the interim progress meeting in person and report every two weeks by telephone on progress until such time as the accounts were prepared. Five weeks later, the accounts had been reconstructed and tax computations prepared for each year. The disclosure report was anticipated a month later than previous suggested although the officer, having been kept informed of progress, was comfortable with the slight extension.

During the following month, we prepared content for the disclosure report focusing on the tax liabilities. Technical analysis was undertaken, and a decision made how to present areas open for dispute. The main area of contention was in relation to the deductibility of motorsport expenses. The expense was significant although the way the team operated provided an opportunity to negotiate the liability:

1. The team sought sponsorship from clients of Scott's business.
2. Sponsorship included the potential to attend races and limited hospitality.
3. Customer logo's and Scott's business logo was included on racewear.
4. Scott's business logo featured on certain event material.
5. The team had a website and provided regular updates as well as a newsletter.
6. Scott's business met the costs of various expenses in relation to the team including machine parts.

The technical position was adopted, and the expenses were allowed as a deduction in disclosing the profits chargeable to corporation tax. Furthermore, the motorsports team appeared to operate on a commercial basis and therefore a trade existed. The trade was loss making most years although the activity had increased, and it could be perceived that there was an intention to become profit making. It was anticipated that HMRC would contest the treatment.

The report was finalised for the client to review and included a certificate of adoption, statement of accounts operated and statement of assets and liabilities. The statements are important given an inaccurate one may result in the case being taken outside of the protection of COP9. The disclosure report included a scope of work undertaken, which set out to HMRC the period and depth of review work done. In part this confirms to HMRC a proper review has been undertaken but also allows HMRC to know where a review has been more difficult due to say the effluxion of time or lack of records. We also set out the primary information made available to permit the review to be undertaken. The report included appendices being the more detailed tax computations, bank records and other primary evidence. In this case, evidence of the sponsorship for the motorsports team was provided.

Scott reviewed the report and agreed with the approach taken and to adopt the disclosure as his own and submit the report to HMRC.

- The concluding Part 3 of this article will be in our October/November 2022 issue.

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