

COP9 case study – the conclusion

In the final part of his three-part series, Anton Lane concludes the tale of Scott and a COP9 disclosure

Six months of Scott's life had passed between the opening meeting and the submission of his disclosure report. During that period, Scott had some anxiety although did not suffer as bad as other clients. The anxiety normally derives from not knowing what the tax, penalties and interest might be. There is also concern about the impact on a relationship and the family. It is not unusual for a spouse to be unaware of the tax irregularities and to be drawn into the disclosure process by virtue of being a shareholder, etc. Scott's wife was a shareholder. We had carefully explained the COP9 process and reassured her that the events giving rise to the irregularities were not entirely unusual. Obviously, we reassured her the disclosure could be managed and whilst an inconvenience at times, it would be concluded as quick as possible.

The time to conclude a COP9 can vary tremendously. The CDF framework was put in place to try to quicken the time taken to settle. The reality is it takes a considerable amount of time to review information going back twenty years, reconstruct accounts, prepare tax calculations, consider technical arguments and present the irregularities to secure the best position for a client. If an adviser suggest that the settlement will follow shortly after the submission of the disclosure report, they will mostly be giving false hope. It is possible to get a quick settlement if the disclosure report is thorough and the HMRC officer is keen. What follows the submission of a disclosure report is a small window of silence of at least 30 days. During this period of silence, the assigned HMRC officer will be checking the thoroughness of the disclosure, the facts disclosed, whether the taxpayer has accepted all deliberate acts, the accuracy of calculations, the merit of technical arguments and preparing challenges.

Scott asked: "What could they challenge if the report is accurate?" For Scott we had considered what acts were deliberate. This requires standing in the shoes of the taxpayer and identifying whether they did something 'intently'. A deliberate act carries the highest penalties, and it appears a fair amount of HMRC officers default position is that taxpayers act deliberately. For example, recently an officer argued that because a taxpayer failed to claim losses and failed to declare subsequent gains, the tax arising on those gains (which would have been relieved by the losses) was done so deliberately. I am confused by the logic of the officer asserting a deliberate act because the gain only arose by virtue of the losses being denied. One of Scott's problems was the simple act of not filing corporate or personal tax returns. I explained to Scott that HMRC would consider the non-compliance a deliberate act because it went on for such a long time. However, I suggested that for a good proportion of the earlier years the act could be careless. There were several other personal issues in those earlier years that could have influenced why returns were not prepared, not least the assurances provided by the then accountant.

A further area of challenge we expected was whether the expenses relating to the motorsports team were allowable deductions in arriving at taxable profits. The expenditure was significant. If not allowable:

- Profits would be greater for corporation tax purposes;
- The expense would likely increase the directors loan account attracting a (section 455) corporation tax charge; and
- The overdrawn loan account would be a benefit in kind potentially attracting PAYE and NIC.

We also anticipated HMRC would scrutinise the calculation of property income. The properties had been acquired over 15 years. For 10 years bank records were available. For the first five years we only had details from Land Registry. Scott had told us about works undertaken on the properties although had few receipts. Finally, a number of the properties had been occupied by employees of Scott's company who paid a nominal rent but also undertook refurbishment works at their own expense.

Scott had also received cash payments for the refurbishment of several restaurants. There was no evidence that the disclosed amount of additional income was correct. Also, where the behaviour of not declaring tax is identified by HMRC, they tend to believe that behaviour is not a one off but can become a habitual behaviour of a taxpayer.

Expense claims to the company had been accounted for in arriving at profits twice – the expense claim had been entered and then the receipts had also been entered. You could derive from the accounts software and the systems in place, this was likely to be an oversight/error by the bookkeeper.

As expected HMRC did choose each 'issue' to debate in more detail. In a meeting following the disclosure submission, HMRC outlined their views:

- The expenses relating to the motorsport activity were not wholly and exclusively incurred for the purposes of the trade.
- Employees resided in property at lower rents could be a benefit in kind.
- Cash receipts were income of the company and the quantum could be greater than that disclosed and could be extrapolated over more years.
- Expense claims had resulted in a double deduction and should be disallowed.

The employee benefit arising from the occupation of property was dropped on the grounds the company could not provide the benefit because the properties were not available for the company to provide. HMRC did not pursue higher rental income.

Following the meeting, correspondence regarding the cash receipts identified that the payments came from one source and no other refurbishments were undertaken for that source. The irregularity was agreed to only relate to that customer and the cash receipts disclosed was accepted.

A review of expense claims was agreed. Random periods were agreed for the review and the results identified that on many occasions the expenses were not deducted twice. It was agreed the incorrect treatment only applied to a few years and the adjustments to profits was minimalised.

The officer was passionately opposed to allowing the deduction for motorsport expenses. Eight lengthy pieces of correspondence followed challenging the technical treatment HMRC were seeking to apply. Evidence was provided demonstrating that customers of the company sponsored events and attended events. Photographic evidence of sponsorship was provided including within a regular newsletter, media coverage and branding included on race attire. Eventually, it was muted in correspondence that the motorsport activity amounted to a trading activity undertaken personally by the shareholder director. Whilst the activity did not produce a profit, it was asserted that there was a profit seeking motive. After much discussion, HMRC accepted that the expense by the company should be disallowed but the activity was a trade. Business accounts had been prepared but not yet disclosed in detail to HMRC. Following the telephone conversation, the agreement was recorded in correspondence and the officer reverted accepting the treatment. The result was whilst the company could not claim the expense, the losses incurred in the trade could be utilised against income. Corporation tax rates were significantly lower than those for income tax so effectively, Scott got to reduce his income tax liability significantly.

The tax treatment was agreed and discussion turned to what was a deliberate act and which acts were careless. The potential lost revenue attached to the cash receipts was accepted as deliberate. Only later years of undeclared property income were accepted and agreed as deliberate meaning only a third of the years attracted a higher penalty. Losses were available to reduce personal liabilities.

A letter of offer was prepared, and settlement entered some two years after the case commenced. This time frame is not unusual. The officer wanted a closing meeting. We would normally avoid a meeting where a HMRC officer exerts their right to tell a taxpayer off and maybe waves their finger in a manner to dictate how naughty they have been. Scott's wife had been unwell and the illness was explained to the officer. However, HMRC still desired a meeting. There is no legal requirement to attend such a meeting although on this occasion we decided to brief Scott and his wife. We also wrote to the office explaining the health of Scott's wife and asserted that any meeting should be conducted in an appropriate manner so as not to cause undue anxiety. A meeting was held and lasted approximately half-an-hour and was conducted in a polite and emphatic manner. It was testament that some officers do have regard for the health of taxpayers and act accordingly.

However, we have unfortunately seen behaviour which is not appropriate on other cases and have on several occasions requested the case is referred to or involve an officer familiar with dealing with vulnerable taxpayers. The involvement of the vulnerable persons team can assist tremendously in gaining momentum to settle cases in a reasonable manner, be more pragmatic on penalties although it rarely affects the tax liabilities. Knowing HMRC guidance, how they operate and how they should

conduct themselves is essential to concluding cases efficiently. An adviser has a duty to achieve the best result for clients whilst being honest and maintaining a professional relationship with HMRC. Often, the involvement of a specialist occurs when another less experience professional has tried to assist a client. In the absence of experience and knowledge, an adviser can potentially expose a client to greater scrutiny, higher professional costs and more personal anxiety. For example, in a recent case, an officer asserted that the act was deliberate early in the case resulting in the adviser providing primary information relevant to persons and entities not being enquired into. HMRC had no right to that information. The case moved from an enquiry into an offshore company to a code of practice 8 case relating to who was the genuine settlor of an offshore structure.

Take care. Be like Scott.

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