

PAYE investigations: what to expect

David Brindley and Grant Summers outline what HMRC is looking for on a PAYE investigation, and how you can protect yourself against one

HMRC is continuing its compliance and enforcement activities with PAYE investigations becoming a key area of focus. As the UK government and HMRC seek to close the tax gap, estimated at £46.8 billion in 2023/24, accountants need to be aware of what will be scrutinised and the risks of non-compliance in order to navigate this complex area.

What is a PAYE investigation?

A PAYE investigation is an enquiry by HMRC into the affairs of an employer to determine if it is correctly operating their PAYE system and providing the correct P11Ds. This includes considering the accurate deduction and payment of income tax, National Insurance contributions (NICs), student loan repayments and other statutory deductions from employees' wages.

These investigations are often triggered by discrepancies in submitted returns, whistleblower reports or data flagged by HMRC's increasingly sophisticated CONNECT system, which analyses information from multiple sources including banks, employers and government agencies. Historically, HMRC faced challenges in identifying errors due to the lack of integration between its systems. However, in recent years, these systems have become significantly more interconnected, enabling HMRC to detect irregularities with far greater accuracy and efficiency.

What is HMRC looking at?

While HMRC say they conduct random enquiries it is extremely unlikely that this is the case, so it is essential to be aware of the possible risk-based areas they can check. In 2025, HMRC's PAYE investigations are more targeted and data-driven than ever before.

Key focus areas currently include:

- **Real-Time Information (RTI) submissions:** Employers are required to submit payroll data to HMRC in real time. Inaccurate or regularly late RTI submissions can trigger a more detailed review into the payroll data.

If there are inconsistencies between payroll and year-end returns HMRC will automatically be prompted to review the error, which could lead to them commencing a compliance investigation.

In these instances, we have seen HMRC check not only the clear error, but to also do a deeper dive into the business' PAYE processes, the mindset being that if there is one clear error, given the diligence failures, there are likely to be others.

- **Employment status and off-payroll working reviews (IR35):** With the rise of the gig economy and flexible working arrangements, HMRC is closely examining whether contractors are genuinely self-employed or should be classified as employees. Where a personal service company is involved, they will also consider whether the IR35 rules apply. Misclassification can lead to significant tax liabilities for employers. We've seen a significant

number of cases in this area, ranging from large construction firms to high-profile individuals such as television presenters. A notable example is the Kaye Adams /Atholl House case, where the matter was escalated to the Tax Tribunal or Courts on four separate occasions. We have also seen HMRC conducting status reviews on fully compliant CIS workers, which again can require careful handling.

From our experience HMRC often adopt an attitude where they appear determined to reclassify workers as employed at the start of the investigation and it is usually our role to challenge HMRC's initial assumption through evidence-based arguments. HMRC will usually interview the employer, but will then go on to interview individual workers as part of their status review.

It is important that advice is taken at an early stage of the investigation as, once HMRC have given an opinion, it is significantly more difficult to displace and may even require the Tax Tribunal to determine the correct position. Given the complexity of the subject, many workers may inadvertently provide misleading answers and it is easy for HMRC's officers, most of whom have not worked in the specified trade, to ask them leading questions, causing workers to be either erroneously classified as employees or as within the remit of IR35.

Wholesale re-categorisation of workers by HMRC can lead to significant liabilities, loss of key workers and in some instances rendering the business no longer viable.

- **Benefits in kind and expenses:** Employers must report and pay Employers NIC on benefits such as company cars, private medical insurance, interest-free loans and reimbursed expenses.

HMRC routinely reviews P11D compliance, scrutinising expense reimbursements, hospitality costs and related payments. In our experience, start-up or fast-growing companies can often fail to keep up-to-date with their P11D reporting obligations. This is a common area where a catch-up exercise and early disclosure can be appropriate.

We have found issues may also arise around directors' loan accounts, which are frequently overlooked during periods of rapid expansion.

- **Use of umbrella companies:** HMRC has been mandated by the government's 2024 Autumn Budget to place a significant amount of resource in the coming years into investigating the use of umbrella companies, particularly where they are used to disguise employment relationships or evade tax.

This includes schemes involving mini-umbrella companies, which HMRC have been challenging frequently as seen in the Elphysic Ltd v HMRC case, which involved misuse of the VAT flat rate scheme and NIC employment allowance by utilising over 18,000 'mini' companies.

The government estimate they will recover £500m in the 2029/30 tax year through a combination of legislative changes and enforcement against users of these arrangements.

- **Cash-in-hand and undeclared sales:** Undeclared cash payments remain a concern, especially in sectors that still have a flow of cash, such as hospitality and retail. The additional turnover can be used to either top up declared wages or pay some staff entirely off the books.

HMRC have many tools at their disposal to identify issues, including data from banks, card processors, and digital platforms. In more recent years, HMRC have launched several projects into electronic sales suppression software.

In more detailed investigations HMRC can review various metrics from across the sector and conduct forensic checks into stock to identify irregularities. HMRC will use this information and cross reference this with similar companies to determine if the cash-card ratio is in line with competitors. We have seen this occur in cases where HMRC have conducted till checks or have obtained information from other regulators information gathering.

- National Minimum Wage (NMW) compliance: HMRC have been actively checking that employers are paying staff correctly, which is more important than ever, following the April 2025 increase in the NMW to £12.21 per hour for workers aged 21 and over.

This includes scrutiny of unpaid working time, deductions for uniforms or training, and incorrect classification of apprentices.

Unlike HMRC's standard approach, where there can be some de minimis levels, if a NMW error has occurred it is extremely difficult to displace it, and penalties may be applied of up to 200% on arrears owed to workers. Additionally, and on most occasions, employers will be named and shamed.

Failing to comply

Non-compliance with PAYE obligations can have serious consequences, including:

1. Financial penalties: HMRC can impose penalties for late payments, inaccurate returns and failure to operate PAYE correctly. These can range from fixed charges for failure to file a return or P11D, late filing or late payment penalties.

They also can be related to behavioural percentage-based penalties on unpaid tax up to 100%.

2. Interest charges: Interest is charged on late payments of tax and NICs, compounding the financial burden.

Following a recent policy change, HMRC's late payment interest rate is currently at 8% per annum. Given this additional burden, early payments on account should be considered where disclosures are required.

3. Reputational damage: Public naming and shaming of employers who fail to pay the NMW or engage in either tax avoidance or evasion can damage a business's reputation with its customers and lenders.

4. Scope creep: Should HMRC officers identify errors outside of their remit within the PAYE investigation, they are likely to refer their enquiry to a cross-tax team who will expand the investigation even further.

From our experience, if this occurs, investigations are likely to take substantially longer to conclude and could extend enquiries into other taxes or the director's personal affairs.

Preparing for an investigation

Proactive action prior to an investigation is key to managing the risks of a PAYE investigation. Employers should:

- Maintain accurate and up-to-date payroll records.
- Conduct regular checks of PAYE, NICs, and benefits reporting.
- Review employment status of contractors and off-payroll workers.
- Ensure RTI submissions are timely and accurate.
- Train payroll and HR staff on compliance requirements.

- Seek professional advice if unsure about complex areas like IR35 or benefits in kind.

While in practice employers often handle PAYE checks in-house, if matters escalate or potential liabilities are identified, then seeking professional advice is recommended.

Employers should consider the following key points:

1. Case management: Identifying and taking early, constructive steps to address HMRC's concerns can help resolve the investigation efficiently and minimise disruption.
 2. Technical defences: Exploring whether there are any additional technical arguments or legislative provisions that may reduce or eliminate potential liabilities.
 3. Scope of HMRC's information requests: HMRC often requests documentation and information beyond what they are strictly entitled to. While they are entitled to investigate areas of risk, some requests may be overly broad or speculative, aimed at expanding the enquiry without clear justification. Understanding what must legally be provided is essential.
 4. Statutory time limits: HMRC has occasionally sought to recover PAYE liabilities that are outside the statutory time limits. Ensuring that any assessments or demands are within the permitted timeframe is a key part of the defence strategy.
 5. Penalty management: Careful handling of communications with HMRC is vital to avoid inadvertently increasing the penalty exposure. Statements made during the investigation can significantly influence the penalty outcome, so it is important that responses are accurate and appropriately framed.
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