



White Paper

What you should tell your client about HMRC compliance checks

By: Diana Flier (Sr. Compliance Analyst, Intuit Ltd.)

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What you should tell your client about HMRC compliance checks

Intuit compliance expert Diana Flier provides the lowdown on what HMRC compliance checks are all about and what accountants should tell their clients to ensure they keep good records in case of a visit from the HMRC. With many clients visiting their accountants in person during Self Assessment season, this is the perfect time to ensure they are prepared in the event of a compliance check.

The Background

You will no doubt have noticed a lot of articles in the last couple of years about new laws being passed around HMRC compliance visits and how far back HMRC can go when calculating taxes owed from previous years.

When HMRC was formed in 2005, through the merger of Inland Revenue and HM Customs & Excise, it inherited a lot of different rules on compliance visits, how HMRC could get information and also the assessment time limits. HMRC did a full review of their processes around powers, deterrents and safeguards and looked to see how these could be brought into line and also modernised.

The old rules were confusing, especially for small business owners, who often don't have the time, or, quite frankly, the desire to research and digest complex tax regulations. The new rules go a long way towards making it easier to understand the various requirements. HMRC also took the opportunity to streamline the various penalties for inaccurate returns, failure to notify and both late filing and late payment. A further consultation on simplifying regulatory penalties closed on 11 March 2011.

HMRC also has the power to make unannounced compliance checks. As the fines could rack up to £3,000, it makes sense to be pro-active and help your clients get their records in tip-top shape as soon as possible.

As poor record keeping is one of the top 5 reasons why businesses fail, getting the books in tip top shape will not only keep your clients compliant, but will also help them run their business better.

HMRC issued a consultation in December 2010 about business record checks. According to the consultation, poor record keeping tends to lead to an underassessment of tax. An HMRC investigation into all SME cases of underpayment, found that poor record keeping was the root cause in 40% (2 million per annum) of these cases. HMRC also stated that despite its agents providing guidance around record keeping, the situation does not seem to be improving. As a result they introduced a compliance checks campaign focusing on the SME sector, targeting 50,000 businesses each year.

In June 2011, HMRC initiated a trial of a new single compliance process across 10 areas within the UK. Results posted in September showed that HMRC found 44% of businesses visited had issues with their record keeping while around 12% had seriously inadequate records. As a result of these findings, HMRC announced that they will be extending their Business Records Checks programme. A further 12,000 checks are planned for this financial year, with 20,000 planned for 2012/13. The number of full time staff on the programme are also set to increase from 30 to 120.

The ins and outs of good record keeping

All businesses, whether a large multi-national or a sole trader, will need to keep a range of records and documentation in order to satisfy a various different forms of legislation, such as Companies Act 2006, Income tax, VAT, health & safety and employee records etc.

In this article, we focus on the HMRC compliance checks, so the record keeping discussed will be in reference to this.

All businesses need to file a tax return with HMRC. The type of return will depend on the type of entity e.g. sole trader, partnership, corporation etc. As part of the tax return, a business will need to report the usual amounts such as income, business expenses and disallowable expenses etc. If HMRC have any queries with the tax return, they can ask to see all records and supporting documentation associated with the return. This includes all invoices (issued and received), receipts etc. To quote HMRC guidance *“You must keep records of all your business transactions.”*

Sole traders and partnerships (with a turnover less than £15 million) are no longer required to send in their accounts along with their tax return, as all the required information will be captured in the ‘*Standard Accounts Information*’ (SAI) part of the return. Business owners will need to keep the required accounts though, as in the advent of an investigation, HMRC will ask to see them. If HMRC find that businesses have not kept all the required records, or if they have not been kept for long enough, they could levy a fine.

What are the types of records that businesses need to keep?

A good accounting system, like QuickBooks, will help keep your clients compliant. Invoices are easily produced and debtors aging reports help business owners keep on top of money due to them. Cashbook, sales and purchase ledgers, vat account, profit & loss and balance sheet accounts are automatically updated on entry of sales and purchase transactions. Stock, petty cash, capital and drawings can also be tracked. Where a payroll module is used, the wages book would be updated each payroll run, as would the payroll liability accounts.

These vary depending on the type of business, if there are employees and also whether the business is VAT registered.

Here is HMRC's quick list of some typical records:

- cash book
- petty cash book
- sales and purchase ledger
- wages book
- invoices and receipts issued and received
- electronic records of sales or till rolls
- details of items not rung through the till
- details of incidental or miscellaneous income – for example rent for accommodation owned by the business
- hire purchase and leasing details
- an inventory of stock on hand at the end of the accounting year
- bank and building society statements, pass books, cheque stubs and paying-in slips which include details of business transactions
 - Encourage sole traders to keep open a bank account for their business, and keep their business & private finances separate
- details of any money taken out of the business for the owner's or the owner's family's personal use
- details of any private money brought into or taken from the business

What actually happens during a compliance check?

HMRC will use a compliance check to verify that a business has paid the correct amount of tax. The compliance checks legislation is applied to the following taxes:

From 1 April 2009

Capital Gains Tax
The Construction Industry Scheme
Corporation Tax
Income Tax
PAYE
VAT

From 1 April 2010

Aggregates Levy
Climate Change Levy
Inheritance Tax
Insurance Premium Tax
Landfill Tax
Petroleum Revenue Tax
Stamp Duty Land Tax
Stamp Duty Reserve Tax

To verify the return they are checking, HMRC will ask your clients to provide the relevant documentation on which a return is based.

They could also check whether all claimed expenses are 'wholly and exclusively' for the business's trade and that the declared profit does not include any disallowable expenses.

So how do your clients find the documentation easily?

Here are some ideas, and they all hinge on a good filing system:

Fixed Assets

Each business asset should be assigned a unique asset number and listed in a single spreadsheet or be entered into the accounting programme along with the date of acquisition, the purchase price, the date placed in service, and the place it was purchased from.

A file folder with each asset receipt is also a good idea. If your clients are being checked for compliance, it is easy to pull the file and present that to the inspector, as opposed to hunting through individual supplier files for each receipt, some of which may go back many years. If you do also want to file receipts by supplier, simply make a photocopy and that way the receipt can live in two places.

Capital allowance schedules can be done on the same asset spreadsheet – but many business owners are not able to calculate capital allowances on their own, so this is something the accountant will likely need to handle.

Bank and Building Society Accounts

Each account should be reconciled to the statement. This is usually monthly, but will be dependent on the statement frequency. Any discrepancies should be researched and corrected in the accounting system,

and if applicable, entries raised for bank charges and interest. Bank statements should be filed by issuing bank, by account, and the monthly reconciliation should be attached to the statement before filing. Doing this shows that the business is serious about monthly processes and keeping track of where the money is going.

Loans and Promissory Notes

A similar treatment can apply to assets. Create a central place to store loans and promissory notes. Loans falling due within 1 year are reported separately to those falling due after 1 year, so documentation should be filed accordingly. Each creditor will need its own file folder, and details of the loan can be stored along with payment details, correspondence and amortisation schedules. The note or loan should also be entered into the accounting system, and amortised monthly so that an accurate picture of the business financial health can be produced.

Continued...

Supplier Records

Many business owners opt to create a folder for each supplier, and everything for that supplier gets filed in that folder. Best practice is to file the newest information on top, *and create a new set of folders each year so that records can be easily found by year.* This last point is fairly important... if you end up having a compliance check, you don't want to hand an inspector a folder that contains many years of data. Instead, limit the possible scope of the compliance check by having just that one year in question in the folder.

Like loans, creditors falling due within 1 year are reported separately to those falling due after 1 year, so documentation should be filed accordingly.

You may also opt to file the bills you pay, in payment date order. If you use financial management software, you can also reference the documentation with a cash book voucher.

Customer Records

Keep a separate file for debtors statements and correspondence but note that Invoices need to be stored sequentially by number. Each invoice must have a unique number, and no gaps in invoices numbers should occur. If the client is using an automated accounting system like QuickBooks, then invoices can be easily found and printed which can provide a good backup if there is a compliance check. However, if the client is still using pen and paper, or excel and word to create their invoices, then a numbered and sequential filing system is absolutely vital.

Payroll Records

If your clients have employees instruct them to keep all payroll input filed in pay run order. (E.g. overtime details, bonus payments etc.) Keep copies of employee payslips filed by date order. Keep separate employee files which contain all your employee contracts, increase letters, disciplinary records and backup documents for statutory payments etc. For larger payrolls, it might be preferable to file sick notes separately in alphabetical order. Keep all payroll returns and back-up documentation grouped by the type of the return.

Reporting Errors

The legislation surrounding tax is both complex and considerable. If the accountant finds an error in a tax return the client has submitted themselves, we recommend immediate disclosure to the HMRC. HMRC will reduce the penalty in cases where businesses have owned up, and the sooner the business owns up, the bigger the reduction in the penalty.

HMRC can be told about any errors either by phone, in person, by letter or by completing an amended return. HMRC further recommend that *"Overall, the person must be positive and as complete as possible when telling you about the disclosure."*

The Scope of the Compliance Check

HMRC might just check one of the taxes. Depending on what they find, HMRC might expand the check to include some of the other taxes. Many accountants opt to be present during a compliance check. If the scope of the compliance check is broadened, they may request that the increased scope is requested in writing so they can prepare properly.

Moving forward – the day to day tasks

Let's face it – most people would rather do anything than their business admin. It's more than just a legal requirement, it can make the difference between a make or break business.

Getting into good habits from day one is key, so encourage your clients to set aside time in their schedule to keep up to date with their admin and filing. Advise them to use a quiet time of the day, when they are unlikely to be disturbed by phone calls or visitors. Stuffing paperwork into shoe boxes / biscuit tins to be done at a later date, usually in the distant future, is just not an option. Within no time at all, they will have such a huge pile of paper, they won't know where to start, so the pile just keeps on growing.

Keeping records up to date will help your clients track expenses, in real time, and help them manage their cash flow more effectively. Using a good accounts management software package like QuickBooks, can help take the pain out of the bookkeeping and cash management tasks.

Additionally, if they are seeking a bank loan, or a credit line from a supplier, your clients are more likely to be successful if their records are in tip top shape.

All in all, keeping good records is a win-win. The client wins because they are on top of their business, and they also win if they are selected for a compliance check!



Diana Flier
(Sr. Compliance Analyst, Intuit Ltd.)

Diana Flier's prescription of what you should tell your client about HMRC compliance checks has been brought to you by Intuit, the company behind the QuickBooks accounting software family. A good accounting system, like QuickBooks, will help your clients keep better business records. Intuit has a programme specially for accountants who support clients on QuickBooks, at terrific value.

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