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RISKY BUSINESS

Introduction

HMRC's new risk-based approach to targeting taxpayers, could not only focus attention on the individual and companies themselves, but also the systems and traits of their tax advisers, in determining whether they are 'low risk' or not.

Risk is ordinarily defined as '*a situation involving exposure to danger; the possibility that something unpleasant will happen*'; the American businessman and philanthropist, Warren Buffett puts it more succinctly '*risk comes from not knowing what you are doing*'; a tenet that applies as equally to the UK taxpayer as it does in the US investment market.

Whilst risk management has long been a central consideration for UK property investors at both asset and portfolio level, taxation is often seen as a compliance matter, almost an afterthought, with little attention given to the potential cash benefits and planning opportunities.

The taxation of business, however, contains many inherent areas where risk is an issue: a regime where the Treasury wants to collect as much tax from companies and individuals, who in turn want to minimise the amount they pay, is bound to give rise to differing views on the treatment of expenditure where the legislation is open to interpretation.

HM Revenue & Customs (HMRC) are targeting taxpayers based upon their perceived risk, placing them into two categories: 'low risk' and rather imaginatively, 'not low risk'. The tax returns of those who are in the former category will not be challenged, whereas all others can expect varying levels of enquiry into their annual return. HMRC are looking for certainty on what tax is to be paid, in return for an open relationship with taxpayers conducted in real time.

A risk-based approach by HMRC is driven primarily by practicality with a need to match and manage resource relative to risk. A relationship rating reflecting sector and inherent business risks is provided: for example, real estate is synonymous with issues of valuation, ownership structure and geography. HMRC recognise that the behaviour of the taxpayer is paramount and will give due consideration to factors such as:

- How the taxpayer reacts to HMRC enquiries.
- Whether there is an aggressive approach to mitigate tax.
- The use of avoidance schemes and level of disclosure.
- Timing and quality of responses to HMRC enquiries.
- The systems the taxpayer uses.

The last point is a key area where a taxpayer can fall down in the eyes of HMRC. Perhaps more importantly, it is also one where the taxpayer can satisfy HMRC to achieve or maintain a low-risk status.

So what steps can a taxpayer take to ensure low risk status?

Good systems will ultimately generate a best practice approach. The systems adopted may affect the business in many areas:

- Training and appropriate expertise of staff.
- Inherent management controls and quality process.
- Use of appropriate software systems that provide an accurate, auditable trail.
- Use of suppliers that share the above traits.



Whilst officially no weighting or badge is given to third-party advisers, in practical terms a taxpayer's risk profile is wholly dependent on the service provided on their behalf. For example, if the adviser is late in providing responses, or there are inaccuracies in answers given, then this will impact adversely on the taxpayer's profile with HMRC.

With less reliance on rolling audits, HMRC's risk based approach is dependent on electronic filing, supported by a data mining process for risk profiling. Under this backdrop, it is not always apparent, even post-*Sarbox* and *Veltema*, that a taxpayer has used a third-party adviser to assist in areas of the return. In any event, the culture of self assessment imposes a duty on the taxpayer, as to the accuracy and honesty of information provided that, *de facto*, passes down to suppliers.



For complex schemes, early involvement with HMRC should be given serious consideration. Dialogue at a planning stage can help to resolve queries and give the taxpayer an opportunity to demonstrate the robustness of the systems in place. In addition, where a relatively high-risk approach is planned, HMRC's non-statutory clearance procedure should be utilised.

It should be stressed that tax planning and compliance are not mutually exclusive and clients will still want to mitigate the tax they have to pay. Recent feedback from clients has highlighted that they value technical expertise and quality of service, as well as consistency and reliability. In short, clients will want to use tax advisers that have a similar risk profile or approach to them, such that their risk profile with HMRC is not disadvantaged.



The issue has been exaggerated by obligations upon Senior Accounting Officers (SAOs) of large companies introduced within the last Budget (now Section 93 Finance Act 2009). This legislation requires SAOs to take 'reasonable steps' to put in place and monitor accounting systems to support accurate tax reporting. The named individual is required to certify annually whether the company had 'appropriate tax accounting arrangements throughout the financial year', as well as explaining any arrangements that were 'not appropriate'. As companies and individual SAOs can be penalised for careless and deliberate errors, then there is even more pressure to ensure that the systems adopted are robust.



Despite HMRC's assertion that no additional burden will be placed upon responsible companies, this will by implication impact upon the systems and processes adopted by third-party advisers. After all, the 'system', however, it is defined, can only be as strong as its weakest link. With a direct culpability, many SAOs will be suffering sleepless nights ensuring that all facets of procedure are watertight. This could also result in a change of adviser!

Perhaps the last word should go to Warren Buffett: **"Only when the tide goes out do you discover who's been swimming naked"**.

For further advice concerning any of the issues raised in this briefing, please contact one of our key individuals detailed overpage, or alternatively call our helpline on 0800 526262. Information on other property tax related topics can also be found on our website at <http://bankingtaxfinance.davislangdon.com>.