Business Records Checks Brief

Introduction

HMRC has today published its response to the consultation document issued in December 2010.

There were a broad range of responses to the consultation document for Business Records Checks (BRC), many of which raised additional questions or made comments outside of the scope of the consultation document itself. This note provides some context on the purpose and basis for BRCs. HMRC is continuing to engage with interested parties as BRC is developed.

The consultation document was clear that HMRC was consulting on **how** and not **whether** to implement a programme of BRC to achieve a step change in the standard of record keeping across the SME population.

However, the BRC process is currently in a 'Test & Learn' Phase, and therefore how BRCs are implemented, and how the checks themselves are undertaken, is not finalised. There is scope for the development of the BRC product to be influenced by the experiences, comments and other input from our customers and professional bodies during this period.

Rationale for Business Records Checks

HMRC's programme of random self assessment enquiries has identified the top 3 errors made by businesses as being:

- understated sales
- overstated expenses
- incorrectly claimed private expenditure

The programme also showed that in 40% of cases the underlying records being maintained by businesses were inadequate. Poor business records are a significant cause of underreporting of tax liability by small businesses.

Prior to the Finance Act 2008, the main way in which HMRC could check whether or not a business was keeping adequate business records was by opening an in-depth, formal enquiry into a tax return which had already been sent to HMRC. But this post return compliance check could be time-consuming and costly for HMRC as well as for businesses. And, because the check could only be carried out after the tax return had been made, it focussed on correcting errors rather than preventing them from occurring.

Following extensive consultation, Schedule 36 Finance Act 2008, included a power to inspect business records **before** the return has been made to HMRC.

BRCs are designed to enable HMRC to inspect the adequacy of a business' records keeping by means of a quicker pre-return check, in order to reduce the burdens on business that would be associated with a subsequent in-depth enquiry post return.

HMRC already provides education and support to help businesses with their record keeping obligations. The help provided includes a useful factsheet and an online record keeping tool on Business Link.

BRCs are intended primarily as a 'compliance check' for businesses where we have identified a risk that their record keeping systems may be inadequate.

Although derived from direct tax legislation a penalty charged is of universal application in that it points to a failure to keep records that will potentially affect the ability of the customer and HMRC to determine the accuracy of the returns for all taxes. The BRC will consider the adequacy and completeness of the underlying business records of sales, purchases and other amounts received or spent which may, in practice, be relevant to more than one tax regime. For example, records of payments to employees will generally be relevant in computing both business profits and for PAYE purposes.

We will charge a statutory penalty where our check discovers **serious** record keeping failures. Charging a penalty is intended to change the behaviour of those who, despite all of the support available, have kept records which fall short of what the law requires

Legal basis for charging penalties in relation to an in-year Business Records Check

We have been asked about the legal basis for charging penalties in relation to an in-year BRC.

Section 12B (3) Taxes Management Act 1970 says

> "In the case of a person carrying on a trade, profession or business alone or in partnership
>
> (a) the records required to be kept and preserved under subsection (1) above shall include records of the following, namely –
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> (i). all amounts received and expended in the course of the trade, profession or business and the matters in respect of which the receipts and expenditure take place, and
>
> (ii).in the case of a trade involving dealing in good, all sales and purchases of goods made in the course of the trade."

HMRC may, by law, check whether or not a business is complying with this requirement before or after a return is made.

What a Business Records Check will entail

The check will consist of an examination of the business records, related to the size and nature of a business, often using sampling techniques, to check whether or not those records comply with the requirements of Section 12B (3). The check will focus on the record keeping as such, rather than on tax liability issues, which may not crystallise until the return is made to HMRC.

The extent to which any failures to comply fully with the statutory record keeping obligations will be deemed 'serious' cannot be a tick-box exercise and will be a matter of judgement, taking account of the nature and size of the business and any previous record keeping failures.

What assurance can businesses take from a Business Records Check?

We will tell businesses whose records for the period examined fall short of what we expect; why that is the case, and what they need to do to put things right. However a BRC is not an approval or endorsement of any one record keeping system and taxpayers will still be responsible for making a complete and accurate return when it is due.

Guidance for HMRC staff

We will publish operational guidance for HMRC staff carrying out BRC in accordance with existing practice. The experience gleaned during the ‘test-and-learn’ period will be used to help develop that guidance.