

Case Study

A cut above...

Abbey Tax recently concluded an enquiry into a hairdresser on behalf of an accountancy client which resulted in some valuable pointers into how the new enquiry regime may be applied.

The client ran two separate hairdresser shops both of which had historically traded just below the VAT threshold and so neither was registered for VAT. In early 2007, HMRC Hidden Economy Team carried out unannounced visits to both shops to review the VAT position and shortly after these visits, the client's Self Assessment Return was selected for a full enquiry.

The Accountant's claim under his Professional Expenses Insurance was accepted and he proceeded to deal with the enquiry with his costs being paid by Underwriters.

After the usual exchange of correspondence and review of the business records, HMRC requested a meeting with the client to discuss their findings and concerns. This meeting was attended by the Accountant, his client and **three** HMRC Inspectors!

During the meeting, the Inspectors raised a number of concerns with the veracity of the business records for both businesses and in particular discrepancies between the records when compared with the information obtained from the unannounced visits. Faced with the HMRC arguments and evidence put forward, the client admitted that some additional takings had been received and taken personally which were not reflected in the declared sales or drawings figures.

HMRC were clearly pleased that the client had made a disclosure and indeed this would help the client when penalties were considered. However, the focus of the enquiry then turned to the quantum of the adjustment required to correct the understatement. As you would expect, the client had not maintained a record of the omitted sales but initially proposed an adjustment of £30 per week for each salon which was then increased to £60 per week per salon. HMRC were not prepared to accept this proposal stating that from the information obtained during their unannounced visits the understated sales figure could have been as much as £105 on that day alone. HMRC therefore proposed an adjustment of circa £720 per week per salon which would have taken both salons above the VAT threshold. Furthermore, HMRC were seeking to apply similar adjustments for 6 earlier years resulting in a proposed settlement figure of approximately £90,000 encompassing Tax, VAT, NIC, interest and penalties.

The Inspectors did not carry out any detailed calculations of the possible omissions; they merely relied on various assumptions to quantify the settlement. Despite this fact, the Inspectors were not prepared to reduce their settlement proposals. The client acknowledged that a substantial settlement was due but felt that this should be less than £50,000 rather than the Inspector's arbitrary £90,000.

Faced with this somewhat intransigent position, the Accountant turned to Abbey Tax for assistance. One of our investigation Consultants took over the handling of the enquiry with our fees being paid by Underwriters under the existing claim.

Our Consultant met with the Inspector to discuss the proposals and after a lengthy meeting, the Inspector agreed to reduce his proposed adjustments to £300 per week per salon but this was his bottom line! Our Consultant did not accept this bottom line and following further negotiations, during which we were able to show that the Inspector had made a number of incorrect assumptions, we negotiated an adjustment of £100 per week per salon in the year of enquiry and the figure was reduced by £20 per week in each of the earlier 5 years.

The level of the agreed adjustments confirmed that the business had always traded below the VAT threshold and so a liability to VAT did not arise. Furthermore, the reduced level of the adjustments resulted in a settlement of £11,000 including Tax, NIC, interest and penalties with which the client was delighted.

It is clear from this case that HMRC have historically exchanged information and have jointly worked enquiries to consider both Tax & VAT implications particularly where a business continually trades just below the VAT threshold. However, with the new powers available to HMRC from 1st April 2009 and the greater emphasis on cross-discipline issues, cases of this nature are likely to increase.

Despite these greater powers it is worth remembering that even when it is accepted that adjustments are required, the quantification of the adjustment needs careful consideration and any HMRC assumptions can be challenged.

For further information please contact Raj Kaur on **0870 607 7000** or email sales@abbeytax.co.uk



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