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CHARTERED ACCOUNTANTS and CHARTERED TAX ADVISERS

Business Record Checks

On 17 December last year, HMRC issued a Consultation Document: "Business Records Checks". The closing date for responses is 28 February, and in March, HMRC will publish details of how they plan to implement their programme of checking the records of businesses. According to the Consultation Document, the intention is to check the record-keeping of 50,000 "Small or Medium-Sized" businesses each year, and the checks are scheduled to begin in the second half of 2011.

HMRC have for some years had the right to inspect the records kept by a business, but in general this has only been done as part of an enquiry into a tax return. In other words, they have only inspected the records after the event, when a set of accounts and a tax return have been prepared using those records.

One of the buzz words in HMRC these days is "Real-time". The idea is that instead of looking at last year's records as part of the process of reviewing a tax return, HMRC will visit the business premises and inspect the records that are being kept of today's transactions. Until now, checks of this nature have been confined to more sophisticated businesses, which are either employers operating PAYE on payments to their staff, or are registered for VAT, and have generally been confined to the specific records maintained for the purposes of these taxes.

From the middle of this year, this will change. HMRC will arrange to visit businesses and to check the records they are keeping of their business transactions. For those who run their business from home, this includes visiting your home, but only those parts of it used for the business.

If the records are found to be inadequate, then penalties will be imposed, up to a statutory maximum of £3,000 for each offence. The Consultation Document asks a number of questions about how penalties should be calculated and when they should be imposed, but the underlying message is that they are likely to be set at a level that will scare people into improving their record keeping where this is not up to an acceptable standard.

Would your records pass an inspection by HMRC? Interestingly, the Consultation Document is quite tolerant about the quality of record keeping that will be regarded as adequate. It gives three examples (Traders A, B and C) of standards of record keeping:

- Trader 'A' issues a paper invoice for every job he does, keeping a copy for himself. He obtains a receipt for every business expense he incurs. Day by day he puts all of those bits of paper into a box to be sorted out later.

- Trader 'B' has a similar system but is not technically competent in tax matters. Whilst the nature of his expenditures is plain from the receipts, he has no clear concept of the difference between capital and revenue expenditure, nor what counts as deductible business expenditure and non-deductible personal expenditure. As a result, he puts the receipts for all his expenditure into his box on the basis that his accountant will sort out what is deductible and what is not.

- Trader ‘C’ has a sophisticated record book into which he neatly enters details of business income and business expenditure, accurately separating capital and revenue. However he records only some of his business takings and only some of their business expenditure.

According to the Consultation Document, both A and B satisfy the legal requirements for record keeping, because their records “are capable of being turned into a correct and complete return of taxable business profit”. Trader C, on the other hand, may well find himself paying a penalty because he has not recorded all of his business transactions!

This article by James Bailey first appeared in Tax Insider magazine (www.taxinsider.co.uk)