Tax Representation

TAXREP 38/05

HMRC CIVIL INVESTIGATION OF FRAUD

Response dated 15 August from the Tax Faculty of the Institute of Chartered Accountants in England & Wales to the HMRC consultation on the Civil Investigation of Fraud issued in July 2005

CONTENTS

HMRC CIVIL INVESTIGATION OF FRAUD

INTRODUCTION

1. This document sets out the representations by the Institute of Chartered Accountants in England and Wales (ICAEW) in response to the consultation document issued by HM Revenue and Customs (HMRC) on 8 July 2005 regarding the Civil Investigation of Fraud.

2. For ease of reference this submission follows the numbered external consultation questions.

   Note: The consultation document has been placed on the Tax Faculty website (with the permission of HMRC) and can be viewed at www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_85227

WHO WE ARE

3. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

4. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

5. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members who pay an additional subscription.

6. The Tax Investigations Practitioners Group is a working group of the Tax Faculty which meets regularly to discuss current issues in tax investigations work. It comprises practitioners from all backgrounds (not just Tax Faculty or ICAEW members) and therefore is well placed to put forward the views of the profession. The Group's focus is on serious investigation cases, particularly those conducted under *Hansard* procedures.

7. COMMENTS ON THE EXTERNAL CONSULTATION QUESTIONS

Q1 What are your views on moving away from the use of PACE safeguards - tape recorded meetings and cautions?

The general consensus is in favour of moving away from the use of the PACE safeguards – tape-recorded meetings and cautions. We therefore support the proposals for a civil procedure to deal with cases involving suspected serious fraud, subject to the reservations and recommendations which we set out below.

Q2 Does the prospect of:

a. HMRC carrying out a civil investigation (if the procedures are refused); assessing the tax, interest and a significantly higher penalty reflecting the lack of co-operation; and

b. prosecution for material false disclosure/statements

provide sufficient incentive to make a full disclosure?

While it is accepted that there have been few, if any, prosecutions as a result of a failure by a taxpayer to cooperate with the 'old Hansard' procedures, or of a withdrawal of cooperation during the investigation, it has to be recognised that the overt underlying threat of prosecution does bring home to taxpayers the seriousness of the situation and provides strong encouragement for them to cooperate. When it becomes clear that there will not, under any circumstances, be any danger of prosecution for the original offences, it is possible that more taxpayers will decline to cooperate than is the case now.

For that reason we strongly recommend that the new Code of Practice (COP) should make it completely clear that stringent and speedy action by HMRC will ensue in the event of non-cooperation. This must include:

1. HMRC launching its own investigation including third party enquiries to banks, advisers, suppliers and customers.
2. Estimated assessments for all years.
3. Action before the appeal commissioners to oppose any postponement applications.
4. Rigorous recovery action in respect of all collectable tax.
5. Pursuit in due course of the maximum possible penalties.
6. Treating failure to adopt a disclosure report as a withdrawal of cooperation
7. No option for the taxpayer to offer or resume cooperation once HMRC have begun their own investigation.

Conversely, the COP should stress the benefits of cooperation such as:

1. Regular progress meetings with HMRC.
2. Where possible, information to be sought from the taxpayer rather than by third party enquiries.

3. Maximum possible mitigation of penalties.

No taxpayer should be capable of being under the illusion that the tax and penalties payable in the event of a failure to cooperate would be less than the tax, penalties and professional fees payable to effect a full disclosure. We recognise the fact that a materially false disclosure may result in prosecution.

We believe that the COP should emphasise that the new procedure is crucial to HMRC's strategy to combat serious tax fraud. An SCI investigation, including a strictly formal opening meeting, must be clearly distinct from any other HMRC investigation. Taxpayers and their advisers must be made aware of its serious nature in any Parliamentary statement and accompanying Press announcement as well as in the COP and in the opening letter.

Q3 What are the practical issues surrounding joint investigations for direct and indirect taxes?

The prospect of joint investigations for direct and indirect taxes is welcomed. Ideally there should be just one investigator but until such suitably qualified resources are available it is recognised that that there will have to be at least two investigators. The opening letter must make it clear which tax is mainly at issue.

We recognise that until the ongoing powers review has been completed, the issues of penalties and settlement cannot be wholly resolved. However, it is hoped that a single penalty regime and settlement procedure will be put in place at the earliest possible opportunity.

Q4 Do you have suggestions for making the procedure more effective and reducing the length of investigations?

The issue which has come up repeatedly in written representations by members of the Tax Investigations Practitioners Group of the ICAEW, as it did in the HMRC consultation meeting on 27 July 2005, concerns disclosure.

HMRC's external consultation paper says the new procedure is designed to provide: 'An overt, less confrontational procedure to resolve tax fraud irregularities'. In that spirit we urge HMRC, even if only on a trial basis, to reconsider their deeply entrenched reluctance to disclose their concerns at the outset of the investigation. This disclosure would only be made after the taxpayer had been challenged and been given an opportunity to confess in his answers to the formal questions. The scoping meeting would afford a suitable opportunity to provide this information. We strongly believe that some relaxation of HMRC's stance on this matter would have an enormously beneficial effect on making the procedure more effective and reducing the length of the investigation.

Further, there are a number of legal arguments in favour of disclosure. Under Article 6(3) of the European Convention on Human Rights, everyone charged with a criminal

offence has a number of minimum rights including 'to be informed promptly, in a language which he understands and in detail, of the nature and cause of the accusation against him'. 'Charge' is an 'autonomous concept' under Convention law. In *Eckle v Federal Republic of Germany* ((1983) 5 EHRR 1) the court held that a 'charge' was 'the official notification given to an individual by the competent authority of an allegation that he has committed a criminal offence, a definition that also corresponds to the test whether the situation of the suspect has been substantially affected'.

The ECHR in *King v United Kingdom* ((2005) 41 EHRR 2) held that the current post *Gill* (*R v Gill* (2004) 1 WLR 469) Hansard procedure does involve a criminal charge. Although this argument is certainly stronger where the threat of prosecution in respect of the subject matter of the Hansard investigation is still extant (unlike in the new proposed procedure) it can still be argued that someone faced with the new Hansard is subject to a criminal charge. Other cases which support this viewpoint include the Court of Appeal decision in *Han* and *Yau* ((1994) 18 EHRR 54) and the decision in *Bendenoun v France* ((1994) 18 EHRR 54). Of course if someone faced with the new procedure is facing a charge under European Convention law, for HMRC not to make disclosure would infringe the taxpayer's right to be informed promptly of the nature and cause of the accusation against him.

We recognise the reasoning behind HMRC's current attitude on the question of disclosing their concerns at an early stage. A powerful and cogent counter-argument suggests that a taxpayer, confronted with the nature and extent of HMRC's knowledge of his previous non-disclosure, would quickly acknowledge – with the prompting and guidance of his professional adviser – the futility and indeed the danger of holding anything back. HMRC should also bear in mind that if it is their intention to resort to proceedings before Commissioners at an early stage in the event of non-cooperation, they will have to disclose the information on which their investigation is based.

It is accepted that a six-month deadline for the submission of a disclosure report is not an unreasonable benchmark in theory. In practice however, as was acknowledged by HMRC at the July consultation meeting, this may not be applicable in all cases and we expect that HMRC will be amenable to reasoned representations on the issue. HMRC will, it is hoped, recognise the difficulties which advisers frequently encounter in obtaining information crucial to the compilation of a full disclosure report and the fine judgements which advisers sometimes have to make between not pursuing a particular line of enquiry in the interests of speed and compromising their client's disclosure.

Finally, we believe that there should be some corresponding onus on HMRC, spelled out in the COP, to respond to disclosure reports and indeed to finalise investigations within specified time limits and that there should be some mechanism for the taxpayer to apply for closure of an investigation.

Q5 What are your views on use of this process being extended beyond Special Civil Investigations and what safeguards would be required?

We are strongly opposed to the use of the new process being extended beyond SCI until it has been tried and tested over a period of years.

Even then, only investigators under direct line management of ex-SCI investigators, who themselves have the appropriate experience, should be allowed to use the process. And in such circumstances proposed settlements should be subject to final scrutiny by SCI and SCI investigators should, as part of their routine local office liaison, review cases being worked under this procedure.

Finally on this issue, we would ask to be involved in further discussions before use of the process is extended to local offices or, as was suggested at the July consultation meeting, to other HMRC Head Office units.

Q6 Do you have any comments on the content of the draft Code of Practice?

As a general comment, the wording, construction and layout of the new COP bear all the hallmarks of having been compiled in some haste and we are confident this will be addressed before the process is implemented. Several suggestions have already been made as to matters which we feel should be covered in the COP. In addition we raise the following points:

- under 'Confidentiality' on page 2, 'allows' in line 2 should read 'requires'.
- the provision for holding scoping meetings should be included in the COP.
- page 7 – delete 'we believe are due' under 'Direct Taxes'.
- page 7 – under 'Records', in what circumstances and using what powers do HMRC envisage records being removed in the course of a civil investigation?
- page 8 – 'including full written disclosure' should apply to direct as well as indirect tax.
- page 9 – it should be made clear that 80% applies to indirect tax.
- page 11 – 'falsified in any way' is not necessary.
- the paragraph on 'Cooperation' in the current COP should be included in the new version.

Q7 Any other views?

- Where an investigation fails to uncover evidence of serious tax fraud, we firmly believe that the professional costs of dealing with the investigation should be admissible as a deduction for tax purposes.

- HMRC have stressed that this is not a 'new Hansard' procedure. We firmly believe that HMRC should reflect long and hard before abandoning the Hansard concept even if this means delaying implementation until Parliament reconvenes and can endorse the new procedure. By 'Hansard concept' we mean not the actual COP9 procedure but the term 'Hansard' itself and the fact that it has been established by Parliament. Most, if not all, tax professionals know the implications of being 'investigated under Hansard', and it is hoped that HMRC will not

underestimate the significant deterrent effect that concept has and its usefulness in encouraging cooperation and disclosure.

- In similar vein, the statement and questions should be handed out separately at the opening meeting as happens now and the third paragraph of the statement should say that the new procedure is designed to encourage full disclosure.

JMM
15 August 2005