

Business Records Checks Review - report
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1 Management summary

- 1.1 This review found clear evidence that the Business Records Checks (BRC) programme is effective in improving record-keeping practices in smaller businesses. The review team considers that these improvements will lead to more accurate tax returns and will contribute to closing the tax gap.
- 1.2 The review therefore recommends that visits designed to healthcheck business records should continue, but in a structured framework of advice and support to help compliant businesses get their record-keeping right, followed by targeted leverage activity to encourage others into voluntary compliance and to identify those most in need of a visit. In this framework we believe that it would be appropriate to issue penalties in limited circumstances for those customers who, given every opportunity to improve their record-keeping, have not done so, or who have not maintained the improvement or where a subsequent tax intervention shows a direct link between poor record keeping and an incorrect tax return.
- 1.3 We also recommend ongoing work with the representative bodies to remove some of their concerns and to ensure that there is a shared understanding of some key points - such as what constitutes 'adequate' records and when records are so 'inadequate' that a return visit is necessary.
- 1.4 To enable that consultation to be effective and to give time for leverage products and improved BRC visit processes to be worked up we recommend a short-term hiatus in BRC visits to businesses not previously visited, or where the visit is not already booked.

2 Background to Business Records Checks programme and the review

- 2.1 BRC are short, face-to-face, real time interventions which aim to encourage greater voluntary compliance in record keeping among small and medium business enterprises (SMEs). They aim to put the customer on the right record-keeping footing and so save costs the business might incur as a result of inadequate record keeping. It is estimated that 40 per cent of SME customers are not keeping adequate records and that this can lead to inaccurate tax returns. The current aim is to undertake a pilot programme of around 6,000 BRCs in 2011/12.
- 2.2 The BRC programme is part of HM Revenue & Customs' (HMRC's) reinvestment plans for the current Spending Review period. Following a public consultation exercise from December 2010 to February 2011, testing of the concept began in 8 locations in April 2011 and expanded coverage began in September 2011, expanding to a full complement of 120 full-time staff by November 2011.
- 2.3 BRC are a key part of HMRC's customer-centric strategy and are aimed at SMEs who are in the willing but need help or potential rule-breaker customer segments. They look to address the failure to take reasonable care behaviours which lead to errors and inaccuracies in tax returns. Whilst HMRC offers a range of educational support on record keeping, BRCs are the only face-to-face intervention specifically aimed at the failure to take reasonable care behaviours and they provide compliance coverage in the SME population where there might otherwise be none.
- 2.4 There are penalties available to HMRC where it is shown that businesses are not keeping adequate records, but at present these are not being deployed except in the most extreme cases of inadequate record keeping. To date none have been issued.
- 2.5 The review was set up to evaluate the ongoing effectiveness of the BRC programme in addressing the behaviours which underpin inadequate record keeping in key SME customer segments and to make recommendations on future direction.

2.6 The objectives of the review were to:

- evaluate whether the current programme is fulfilling its objectives in line with the Impact Assessment published in December 2010
- evaluate the effectiveness of the pilot compared to the costs and benefits set out in the Impact Assessment
- evaluate the policy objectives by reference to the business burdens imposed and taking account of the Government's growth agenda and the current economic climate
- consider whether BRCs are the most appropriate way to achieve the policy objective
- consider whether further work should be done with the representative bodies and others to:
 - identify the role that tax agents play in the record-keeping process and the work they undertake to ensure that taxpayers are able to submit a correct and complete tax return
 - provide guidance to businesses and advisers about what minimum records are needed in order to satisfy the legal requirements
 - improve existing knowledge and understanding of the role played by records in ensuring that a tax return is correct and complete
- make recommendations on the future direction of the programme

The full terms of reference are included at Appendix A.

2.7 Any recommendations that the review makes must be set within the context of HMRC's customer-centric strategy and contribute to HMRC's strategic objectives of maximising revenue flows with an improvement in the customer experience whilst delivering sustainable cost reductions.

2.8 It is not, of course, always possible to do all of these, but the overall future direction recommended by this review should take account of all aspects of the strategy and look to maintain and improve on all aspects compared with the current position.

2.9 The review consulted with tax professionals and other key external representatives and we are grateful for their time and willingness to discuss their views and to work with us to consider the right way forward for this work.

2.10 The review also consulted with officers who have been undertaking the checks to gain their insights into customer reactions to the visits and the issues found. Again we are grateful for their time.

3 Options and conclusions

3.1 The review considered four possible options:

1. cease all BRC visits and abandon the programme
2. do nothing - the 'as is' option
3. amend BRC to become a purely educational tool
4. amend BRC to be a more tightly focussed compliance intervention

3.2 Each of these options is considered below, along with the relevant considerations, findings, conclusions and analysis which led us to accept or reject those options.

Option 1 - cease all BRC visits and abandon the programme

3.3 This option would be the most viable option if the policy objectives were no longer valid, or the present programme is not meeting those objectives.

Policy objectives.

3.4 Traditional tax audit interventions are time-consuming and expensive, are aimed at the highest risk businesses in the SME community and mainly address more serious non-compliance. They present a good return on investment, but with increasingly restricted resources the overall coverage of the 4.6 million SME businesses will always be limited.

- 3.5 Although audits are aimed at customers whose individual under declaration of tax is likely to be high, there is a large portion of SME businesses who are making errors or are failing to take reasonable care. For these customers the individual under declarations are likely to be low in value, but the cumulative effect is very high. HMRC needs to find an effective means of intervening with this portion of the customer base which is both cost-effective for HMRC and reduces the burdens on businesses. Traditional interventions are time-consuming for businesses as well as HMRC.
- 3.6 BRC present an opportunity to increase coverage among the smaller SMEs where the risk of serious non-compliance is lower, but the incidence of error or failure to take reasonable care is greater. This increased coverage has an effect not just on the businesses visited but also on other businesses in their network, who will hear of the possibility of a visit and the importance of good record keeping and who will positively alter their own behaviours as a result. The short visits can put customers onto the right track much more quickly.
- 3.7 HMRC's Spending Review reinvestment also covers other activities to reduce error through initiatives aimed at designing error out of the system through process redesign and improving the targeting and tailoring of primarily interactive, on-line education and support. HMRC also looks to influence the potential rule breaker segment by making better use of publicity to deter those who fail to take reasonable care, are reckless and/or who might be tempted to break the rules.
- 3.8 Closing the tax gap and improving compliance among the large SME population remain valid policy objectives in these times of austerity. The disadvantage that HMRC faces in pursuing any upstream activity to change behaviours is that there is no immediate impact on the amount of money paid to the Exchequer, as it is an up-front investment for longer-term gains. However, the other interventions which provide more immediate cash gains are more expensive and time consuming (for both businesses and HMRC) and are not aimed at the same part of the SME population as BRC.
- 3.9 This review concludes that the objectives of the BRC programme - to close the tax gap by improving record keeping in the SME population - remain valid.

Evaluation of the BRC programme

- 3.10 Originally the benefits from the BRC programme were estimated and issued in the Impact Assessment published alongside the consultation document. This gave a figure of benefits across the Spending Review period (to end of 2014/15) of £600 million. This was based on HMRC undertaking around 50,000 visits each year.
- 3.11 Since this assessment we have revised our likely visit numbers to around 6,000 in 2011/12 and 20,000 in each subsequent year. We have, therefore, also revised the assumptions around the likely effects of the programme. The revised estimate is in the table below, and is based on an assessment of the likely preventive impact of the intervention on the customer visited - giving a two year improvement in record keeping and, therefore, tax compliance - and the deterrent effect on their network of contacts:

Table 1: forecast benefits from BRC programme

2011/12 (£ million)	2012/13 (£ million)	2013/14 (£ million)	2014/15 (£ million)
0	13	49	62

- 3.12 The forecast benefits from the programme are based wholly on the preventive and deterrent effects of the interventions. Therefore the benefits are all for the two years following the intervention, with no benefits accruing in the year the visit takes place. This gives a revised benefit for the Spending Review period of £124 million. These figures do not include any amounts attributable to penalties.

- 3.13 A full evaluation of whether the BRC programme is realising these benefits can only be done when the returns from customers who have had a check can be compared to a control group of similar businesses who did not have visits. This evaluation would show, on an aggregate basis, whether the improvement in record-keeping carries through to improved accuracy in businesses' return and, ultimately, to increased revenue. This evaluation can only take place during the year following the visit, after the customer has submitted their tax returns. Work is in hand to evaluate BRC in this way during 2012/13, but obviously the results are not available to inform this review.
- 3.14 Some evaluation can be found where other countries have been implementing similar schemes. The broad format of the BRC was derived from successful schemes run in other countries and reported in Organisation for Economic Co-operation and Development (OECD) research.¹ An extract from the report reads:

Promoting effective record keeping

Poor record keeping is a recognised compliance risk for many SMEs and improvements in this area are central to accurate reporting. Not only is this sound business practice for taxpayers, it also provides an audit trail of cash and other financial transactions. As such, there is an incentive for revenue bodies to provide support in this area and a number of countries have programmes in place.

Box 31: Canada - Books and Records Review Programme

In 2000, Canada implemented a Books and Records Review Program (BRRP) programme primarily focusing on SMEs in traditional high cash based industries - construction, restaurant and food services, and retail businesses. The approach involves limited reviews of business' books and records by audit staff in relation to the ability to meet Income tax and Excise Tax reporting requirements. A books and records review is a limited review, not an audit and no assessment is raised as a result of a review. The reviews require considerably less time and are less adversarial and intrusive to the taxpayer. An evaluation of this programme has found that it is highly regarded by taxpayers and while a compliance instrument, has a strong high service emphasis. Subsequent audit activities on taxpayers who have previously received a books and record review were found to have lower adjustments. It was also found there were significant cost savings in using a books and records review in comparison to a full audit.

- 3.15 Based on this information from Canada it is likely that BRC checks will have a resultant impact on more accurate returns, but whether the level of that impact will meet the forecast benefits cannot currently be quantified.
- 3.16 There are other, in-year, ways in which we can measure the effectiveness of BRC, using statistics from the visits undertaken to date. It is still quite early in the life of BRC. At the time of writing only 2437 visits have been completed and test-and-learn is still in effect. Any evaluation that we do at this stage, therefore, must come with the caveat that the overall numbers are small and some population sizes may not be statistically valid. Nevertheless the information is interesting and does present a strong indication that BRC is successful at improving record keeping in businesses, at least in the short-term.

¹ OECD Forum On Tax Administration: Compliance Sub-Group. Information Note on Managing and Improving Compliance: Recent Developments in Compliance Risk Treatments. March 2009

Table 2: Statistics from the BRC programme (correct at 4 January 2012)

Total number of visits	2,437
Number of Green assessments	1495 (61 per cent)
Number of Amber assessments	681 (28 per cent)
Number of Red assessments	261 (11 per cent)
Number of follow up visits	61
percentage improved to Green assessment	80 per cent
percentage improved to Amber assessment	16 per cent
percentage with no improvement	3 per cent

- 3.17 The figures showing the improvement in record keeping for those customers who have had follow-up visits are encouraging, albeit that they are based on a very small number of return visits.
- 3.18 On the basis of the information available, both from the current programme and from programmes run for longer periods in other countries, this report concludes there is evidence to suggest that the BRC programme is meeting the original policy objectives and would, over time, help with tax gap closure.
- 3.19 Based on the conclusions above that the policy objectives remain valid and that the BRC programme is meeting those objectives, we conclude that closing down the BRC programme and ceasing all visits is not a viable option.

Option 2 - do nothing

- 3.20 Having concluded that closing the BRC programme was not the right way forward, we must consider the most cost-effective alternative, which is to continue with the BRC programme as it is currently constituted. This option would not preclude the use of continuous improvement tools to increase the efficiency of the visits and the risk targeting. Consideration would need to be given on whether or when to increase the use of penalties for inadequate record keeping.
- 3.21 This option would be the most viable option if the reason for this review was simply to ensure that BRC is the right way forward and to offer recommendations for continuous improvement activity. However, the strength of the concern from the representative bodies over the current checks cannot be either under-estimated or ignored.

Representative bodies' views of BRC

- 3.22 The representative bodies' nominated spokespeople have been very generous with the time and consideration they have given to this review. The strength of feeling against BRC in the agent community cannot be over-stated. They have a number of deeply held concerns which we will cover here.
- 3.23 The representatives feel very strongly that the consultation exercise which began in December 2010 was 'too little too late'. Although it was a public consultation the scope of the consultation was about 'how best to implement a programme of BRC with penalties for significant record keeping failures', not about whether BRCs were the best way to proceed. This came as something of a surprise to the forums who regularly meet with HMRC who felt they could, and possibly should, have been consulted on the proposal long before it got to the public consultation stage. The view has been expressed that BRC may have been much more widely accepted if there had been a longer lead-in time and agents had time to get their clients prepared.

- 3.33 There had been an earlier consultation, in May 2007, on the wider subject of a new approach to compliance checks, where the idea of an in-year check on business records was first mentioned. The representative bodies did air their potential concerns at the time, but further consultation does not appear to have taken place until BRC Consultation Document was put out in December 2010.
- 3.34 There is much we could say about the time taken to consider policy options and resourcing, the speed with which the Spending Review proposals had to be prepared and the purdah which may have surrounded them. But the fact remains that the representatives who want to work with us on improving the relationship between HMRC and the tax professional bodies continue to feel that the way in which BRC were introduced has damaged that relationship.
- 3.35 This review concludes that there is a real and genuine need to consult with the representatives more thoroughly on the BRC approach to attempt to repair some of that perceived damage.
- 3.36 The representatives raised other objections to BRC as well. Possibly the most fundamental of these is that they do not consider that it is appropriate for HMRC to intervene in this way in their relationship with their clients. They contend that they have advised their clients on record keeping (including, often, advising that the records are adequate) and if HMRC visit and tell the clients that the records are not adequate that will put unreasonable pressure on the client/agent relationship. They are also concerned that if HMRC issue a penalty to the customer then there is the possibility of the agent being sued by their client.
- 3.37 This is a difficult concern to address. It cannot be right that HMRC do not visit businesses who have tax representatives and it is also true that HMRC checks do find mistakes in the returns of represented businesses. In 404 BRC visits where the customer had an agent (visits selected at random from the overall number) 40 per cent of the businesses had inadequate records, with 10 per cent showing serious inadequacies. We believe that if we work with the representative bodies to gain agreement on the way forward for BRC, and on some of the definitions around adequate records, the likelihood of such a major divergence of opinion would be reduced.
- 3.38 Two further concerns are whether HMRC can reasonably assess, mid-year, if the records are adequate to complete the tax return, and whether the visiting officers are well enough trained to offer that sort of advice. The representatives' point out that they have trained for many years to earn their qualifications to advise businesses. The majority of our BRC Visiting Officers have also trained for many years in tax matters. In consultation with their manager, newly appointed Visiting Officers agree and undertake a range of Online learning modules appropriate to their recent compliance experience. The modules undertaken will be bespoke to the identified needs of the individual. They work through a BRC Visiting Officers Learning Pack and attend face to face training delivered by other experienced compliance staff. The workshop covers the key aspects of BRC policy and processes, draws on experience from BRC visits undertaken by BRC Teams and includes a cradle to grave case study as well as other BRC example scenarios. The review found that the training given to officers was sufficient to enable them to make an informed judgement on the adequacy of the records.
- 3.39 Many tax agents will spend quite a lot of time at the year-end filling in the gaps in the records given to them. This is often possible by reference to original suppliers, or other, supplementary records. They contend that inadequate records, or records with apparent gaps mid-year, do not always, or even usually, translate into an incorrect return at year-end. They do concede that it might be more likely that inadequate in-year records would translate into an inaccurate tax return for unrepresented businesses if a business does not keep even minimum records.
- 3.40 Again this is most likely to be resolved with thorough consultation. If all sides are clear on the minimum records necessary for a business to keep it is more likely that representative

bodies will agree that, even with their expertise, the end-of-year tax return is unlikely to have been wholly accurate if the customer is not keeping those minimum records.

- 3.41 The representative bodies also disagree that HMRC have the legal basis to raise penalties in-year for inadequate record-keeping. They contend that the penalties are only appropriate if it can be shown that the inadequate record-keeping contributed to mistakes on the actual return. HMRC's view (supported by solicitor's opinion) is that the legislation does allow for penalties to be raised for inadequate record-keeping, whether or not that leads to an incorrect return - we do not have to prove the link between the two. The representatives also believe that there is scope for reputational damage if we issue a penalty for inadequate record keeping and the business is subsequently chosen for an audit and we discover that the return is accurate.
- 3.42 It is not within the scope of this review to consider the legality of the penalty regime, but we include the view here for completeness without drawing any conclusion.
- 3.43 There was genuine concern from the representatives that BRC as currently set-up, and certainly if we begin to charge penalties, is causing reputational damage to HMRC. They report that customers, and agents, still believe that BRC is a fishing exercise designed to 'catch them out' and that, unlike many direct tax interventions, it is not seen as sufficiently targeted to be anything else. The contention is that we should be able to explain to the customer, if asked, why they have been selected for a check. Currently, they report, visiting officers do not, or can not, explain why individual businesses have been selected for a check, reinforcing the belief that we are fishing or just picking businesses at random for these checks.
- 3.44 This, again, is an issue which can be addressed though greater consultation and understanding as well as improved targeting of the visits. Businesses may well always be nervous when faced with a visit from HMRC, but improved communication and publicity could reduce that considerably. We found that the visiting officers we spoke with were able to explain, very clearly, why the visit was taking place although, of course, it is not appropriate to disclose the detail of the risk assessment which may have selected a particular business.
- 3.45 These are the main points which were raised by all the representatives we saw. There were other points raised by some individuals.
- 3.46 The concerns of those speaking on behalf of the unrepresented are that HMRC does not do enough to make customers aware of both the legal requirements placed on them once they go into business and the penalties for not complying. They are keen that we should interact with new businesses as early as possible and that we should, at all stages of our interaction with that business, be clear about their obligations, the penalties for non-compliance, and their rights.
- 3.47 Another concern was raised that most customers, and many agents, still do not understand the implications of prompted and unprompted disclosure on any penalties they may be issued for incorrect returns. The concern extends to BRC if a customer discloses previous mistakes during a visit. Once investigated and quantified the disclosure would almost certainly be seen as a prompted disclosure (as it happened during a visit) and the customer would get a lesser reduction than if the disclosure had been unprompted. While, obviously, HMRC cannot cease visiting to allow customers more scope for unprompted disclosures, the view is that we need to make the implications of not disclosing immediately much clearer. It is, clearly, outside the scope of this review to make recommendations around the publicity given on new penalties, but we will pass the representative's views to the appropriate team in HMRC.
- 3.48 It is right to cover here that many visiting officers report very positive feedback from the customers who have actually had a visit. Many are pleased to have been helped and are

reassured by the non-confrontational contact with HMRC - sometimes the first contact they have had in some years.

- 3.49 Given all of the views expressed above we conclude that more extensive consultation and agreement with the representative bodies on the aspects of the BRC programme highlighted above would considerably reduce the concerns. We conclude that continuing BRC as it is currently set up while carrying out this consultation is unlikely to be as productive and, therefore, we conclude that the 'do nothing' option is not the right way to proceed.

Option 3 - BRC as a purely educational tool

- 3.50 There is also an option to use BRC purely as an educational tool. This would remove any possibility of penalties being used as a result of the visits and would remove some of the representative bodies' concerns.
- 3.51 This could be the right option if we consider that the possibility of penalties adds nothing to the likelihood of customers improving their record-keeping and if this is the most cost-effective way of educating a large number of SME customers.

Penalties

- 3.52 There is provision in the legislation for HMRC to issue penalties for inadequate record keeping. The amounts vary between the taxes, but the largest available penalty is for Income Tax and Corporation Tax and this allows for an amount 'not exceeding £3,000'.
- 3.53 No penalties have been issued during the test-and-learn phase of the BRC programme, the benefits calculations are not predicated on any degree of penalty application and it is unlikely that issue of penalties would ever be widespread given a current level of 11 per cent of businesses having records assessed as being seriously inadequate and a 96 per cent improvement rate.
- 3.54 However, there is evidence in the OECD report mentioned earlier that other countries do use a penalty regime in conjunction with interventions similar to BRC. This says:

Box 32: Australia - Record Keeping Assessment Tool

Australia has also developed a record keeping strategy that incorporates education, supporting products and a graduated approach to enforcement to encourage compliance behaviours particularly for new businesses. An electronic Record Keeping Assessment Tool (RKAT) is used by the tax officer that provides an overall assessment of the SMEs records with a copy provided to the taxpayer. Where record keeping practices are found to be deficient, advice for improvement is provided, including advice on ATO record keeping products such as the free electronic record keeping software (e-Record) and the Record Keeping Evaluation Tool (RKET).

The record keeping strategy also includes a revisit program for those taxpayers who 'fail' the initial record keeping assessment. Taxpayers are advised of this revisit program and the penalty regime under the new tax system that may apply to those who choose not to take corrective action after being given advice and opportunity to do so'.

- 3.55 Unfortunately, there is no assessment reported in the document of how successful the Australian programme has been in improving record keeping or return accuracy. However, it is unlikely that there will be continuing long-term benefits from a programme if there are no sanctions available for those customers who do not improve their record-keeping.
- 3.56 Even if more widespread application of penalties is not the right way forward for BRC, it will always be the case that an officer on a visit who identifies potentially serious inadequacies which may have affected the tax paid or payable by that customer cannot ignore that possibility. If the visit is badged as purely educational those referrals become more difficult.

Education

- 3.57 It is clear that there is a need to improve the record-keeping of SME businesses and the provision of education through a variety of channels is both valuable and necessary. Much work is already underway.
- 3.58 However, face-to-face (largely one-to-one) interventions are an expensive way of educating customers. Without the possibility of a penalty or further action it is possible that much of the preventive and deterrent effects on which the forecast benefits are predicated would be lost over time.
- 3.59 We did conclude that there is a need to make the educational tools currently available more widely known and to work with the representative bodies to promote these with customers who would benefit from the help.
- 3.60 Ultimately, the cost of one-to-one interventions and the potential impact on the benefits of the programme meant that this review concludes that maintaining BRC as a purely educational tool is not a viable option.

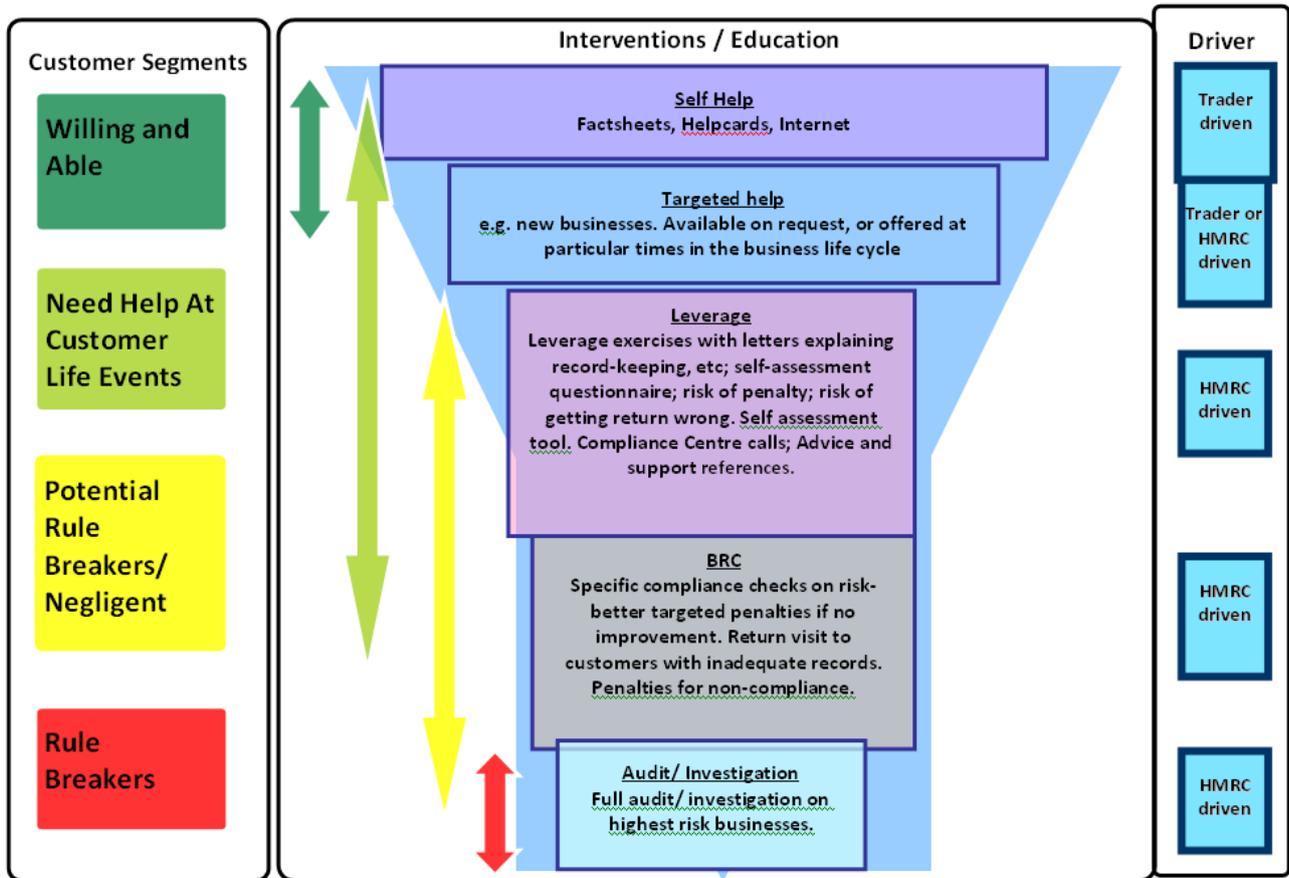
Option 4 - amend BRC to be a more tightly targeted compliance intervention

- 3.61 The conclusions reached on the other options mean that this option is the most viable. However, we do consider that in making BRC a more tightly targeted compliance intervention, there is a need to highlight and expand education and introduce some leverage activity to balance the picture and give willing businesses every opportunity to improve their record-keeping.
- 3.62 It is important that any new format takes into account the concerns raised by the representative bodies. As well as a need to consult on some of the detail of the checks and the definitions used, we believe there is also a need to implement a more structured hierarchy of educational support and interventions designed to improve compliance. At present a business records check can be perceived as a 'stand-alone' event which is randomly targeted at customers who have not previously been given much opportunity to understand their record-keeping obligations. While this perception is not accurate, it is damaging to both HMRC and the BRC programme and must be addressed in the future format.
- 3.63 We recommend, below, the work we consider needs to be done to build the new framework. We consider that there is a need for some intensive work immediately following this review to drive through some of the major changes needed. We think there is a need to temporarily suspend BRC visits while this initial work is done - restricting visits to the remaining follow-up visits and any visits already booked.
- 3.64 We would not see this hiatus lasting very long - perhaps into early 2012/13.

Future framework

- 3.65 We see this as an education and compliance 'funnel' with decreasing numbers of customers affected by each 'intervention' and with the interventions increasingly aimed at the less compliant sectors. We believe that this funnel would offer customers a greater opportunity to improve their record-keeping than currently, and we consider that a further step could be introduced to undertake leverage activity.

Figure 1: Education and Compliance ‘funnel’



- 3.66 The first level of the funnel would be **self-help** available to customers who are willing and able, or who are willing but need help around life events. Much of this material is already available and much work is underway to sign-post businesses to it. More can be done with the help of the representative bodies and work should be done with the representatives to improve both the content of the educational material and the extent to which they use it with their clients.
- 3.67 The next step down the education and compliance ‘funnel’ would be **targeted help** - aimed at customers who have reached a critical point in their life-cycle and who might need help to ensure that they meet all their statutory requirements around record-keeping and accurate tax returns. This could be at the start-up of a new business, at a time of growth (perhaps when they are approaching the VAT threshold or when they first take on employees), or if the business diversifies. This targeted help is most likely to be initiated by HMRC, but could be requested by a customer or their agent where there are planned events they want to attend. Again, many of the products are already available. Some products, we are told, are provided free by agents and representatives and through Business Link, My New Business etc. But more work needs to be done to make the available products known to customers and their agents and to promote their use.
- 3.68 The Low Income Tax Reform Group have many good ideas of other agencies who could be used to sign-post customers who are asking for help to HMRC. These include Tax Aid, Tax Help for Older People, banks (when businesses ask for loans to start-up or expand), Department for Work and Pensions, Department for Business, Innovation and Skills, etc. Many of the customers approaching these agencies are not represented and may be most in need of the help HMRC can provide.
- 3.69 There is also much work going on in the Cabinet Office on how to engage with customers and change behaviours. This work has already been used to help design HMRC’s current

round of campaigns and there is likely to be much that can also be learnt for implementing BRC and other compliance interventions.

- 3.70 **Leverage exercises** aimed at groups of businesses who might be expected to be at a higher risk of inadequate record keeping would be the next stage of the process. These can be targeted in a number of ways:
- at those sectors who have traditionally been found to have inadequate records (cash businesses, tradesmen, public houses etc)
 - at a particular post-code or set of post-codes
 - at customers who our information leads us to believe might be approaching a key event in the business life-cycle
 - at those identified by the current most-successful risk profile for BRC visits
 - at those businesses who have been identified for an HMRC campaign approach, but who were, perhaps, considered too small to necessitate the more intensive campaign interventions
- 3.71 The leverage interventions will be key to the success of this stage. When we discussed this with the representative bodies opinions were divided on how intensive the letters or calls should be. Some favoured a purely educational approach, while others felt very strongly that the interventions should set out the customers' statutory obligations and make it clear that there are penalties and sanctions for those who do not comply. They should also sign-post those who want to comply, but think they need help to do so, back to the targeted or self-help available at the earlier tiers.
- 3.72 We would suggest that the letters or calls should:
- explain the background and context - inadequate record keeping can lead to incorrect tax returns
 - explain why the customer has been sent the letter - they are in a category of business considered to be at risk of keeping inadequate records; or HMRC are writing to all businesses in a particular area to offer help and advice
 - sign-post the customer to the self-help or targeted help if they want to learn more and improve their own record-keeping
 - possibly offer a self-assessment 'check-list' or 'work-book' that customers can use to reassure themselves that they are meeting their statutory requirements, or a self-assessment questionnaire which could help HMRC with its future targeting
 - offer the possibility of customers sending the questionnaire back to HMRC so that we have increased knowledge of the customer's record-keeping knowledge and ability
 - make clear that the business might be chosen in the future for a BRC visit
 - explain that if we find inadequate record keeping that there are penalties we might apply
 - explain that inadequate record keeping can lead to incorrect tax returns and detail the penalties available if we do a full enquiry and find under-declarations
- 3.73 We believe that these leverage exercises will both help to identify businesses who need a BRC visit, and also serve as a sharp reminder to those who are not taking reasonable care with their business records that there could be sanctions or penalties if they do not pay more attention. The preventive and deterrent effects from BRC visits should be enhanced by the leverage exercise - even among those who are not subsequently visited.
- 3.74 HMRC should then use the information available from the leverage exercise to target businesses for BRC visits. Those customers who take up the opportunity to educate themselves, or to receive some targeted help, may be seen as less in need of an immediate visit. Similarly, those who send back the self-assessment showing that they are receiving sound advice and support and/or that they clearly understand the requirements and are keeping records which are likely to be adequate (or they indicate this on a call) might be deselected for a visit.
- 3.75 Leverage and selecting businesses for visits could also be done by means of telephone contact. These would require a detailed script for the operators, again setting out the

statutory requirements and sign-posting customers who want further help to the self-help or targeted help options. The telephone operators could complete a short questionnaire (similar to, but much shorter than, the one used by the BRC officers) to get a 'first-feel' for the customer's understanding of record keeping and the likelihood that they would benefit from a BRC visit. We should be prepared to speak to appropriately nominated agents or representatives if customers feel that would give us a better view of the adequacy of their records.

- 3.76 The results of the leverage exercise should produce a list of businesses who are in a high-risk category and who either have not responded to the leverage exercises, or have provided responses which show that they are not receiving help and advice from a representative or HMRC and/or that they have little understanding of what adequate records they need to keep to produce an accurate tax return at the end of the year.
- 3.77 These businesses should be subject to a **BRC visit**. The improved targeting should ensure that many fewer customers with adequate records receive a visit.
- 3.78 We cover below changes we consider need to be made to the visit process to improve productivity and reduce the impact on the customer and the point at which penalties could apply.

A revised BRC process

- 3.79 There are a number of areas where we consider that the BRC process could be improved to:
- address representative bodies' concerns
 - improve the cost-effectiveness of visits
 - reduce the burdens on compliant businesses

- 3.80 The guidance given to officers clearly states:

The purpose of the record check is not to focus on the specific format of the business records, but to ensure whether the prime business records are:

- **adequate** - in that there is a clear record in one way or another of all business money 'in' and 'out' and the records maintained are such that it will allow an accurate interpretation to be made as to the nature of those receipts and expenditures without the need for any assumption

- 3.81 It goes on to say:

The records do not have to be in any particular format, but they should be up to date and kept in sufficient detail to:

- allow the person to make a correct and complete return
- allow the person to calculate the correct amount of tax or duty to be paid or claimed
- enable us to check the figures on the return or claim

- 3.82 The tax representative bodies have anecdotally reported instances where officers have sought to direct businesses in the types of records they must keep, including suggesting that one customer must have a till for his cash business. While this might be good practice, and officers are able to suggest that this might make money management easier for the customer, it is outside the remit of the BRC to insist upon any specifics and the findings of this review are that this is clearly stated in the guidance and training given to officers.

- 3.83 It is clear from this review that there is also much debate over the definition of what constitutes 'adequate' records. For example, a customer might decide not to claim certain purchases as a business expense on their tax return. This might be because they consider that the cost of keeping the necessary records and/or apportioning the cost between business and personal use outweighs the benefit of claiming back those expenses against tax due. In these circumstances the customer would not need to keep a record of those

expenses. We raised this issue with visiting officers and found that they understood this point, but it needs to be made clearer in the guidance given to officers.

- 3.84 As a further example, HMRC considers that all businesses should keep a record of cash drawings. The representative bodies contend that, in a small business which keeps accurate records of their takings and of the expenses which they intend to claim as business expenses, the balance will be subject to income tax whether it is in the customer's bank account, in petty cash or the till, or whether it has already been spent. It is not, therefore, **always** necessary for the customer to keep a record of drawings in order for them, or their agent, to produce an accurate tax return.
- 3.85 These, and other issues raised by the representative bodies, need further exploration to ensure that they are completely covered in both the guidance and the training given to visiting officers. The representatives also have concerns around the route if the customer, or their agent or representative, disagree with HMRC's assessment that the records need to be improved or extended. The consultation and clear guidance should reduce the instances, but where they do occur they should be settled in correspondence with the officer and their manager.
- 3.86 We also found that the current visit process is very prescriptive, with visiting officers required to complete a quite lengthy questionnaire for all visits, even where it is clear that the records are in order. The standard template contains some duplication and the questions do not always follow the natural flow of the visit. This adds to the time spent at the customer's premises - a cost for both HMRC and the small business. The requirement for a minimum number of checks, or a minimum period to be covered, also seems unnecessarily prescriptive. Applying PaceSetter² tools and techniques to the process would, we believe, result in reduced visit times and more efficient use of the resources allocated to the programme.
- 3.87 Businesses subject to a BRC visit would be assessed as either having adequate records or inadequate records. However, there will need to be further stratification of those assessed as having inadequate records to enable appropriate follow-up action to be taken. Those customers whose records are inadequate, but where very little is needed to bring them up to an acceptable standard, might just get a letter explaining the changes that are necessary. This might require a degree of assessment on the part of the visiting officer around how capable the customer is of making and maintaining the necessary changes.
- 3.88 There will be other customers whose records are seriously inadequate and require a much greater degree of correction to bring them up to an adequate standard. These customers should also receive a letter explaining the necessary changes and should have a follow-up visit after an agreed amount of time to ensure that the changes are made. It is important if we are to work constructively with the representatives that there is a shared understanding of when this point will be reached.
- 3.89 This, of course, is already an additional cost to the business as it will require the customer to give up more time for another visit. We do not consider that it is necessary to impose further sanctions or a penalty after the initial visit in any but the most severe of cases - for example where there are no records or where the customer has destroyed records to prevent or inhibit the check.
- 3.90 If, on return, the officers find that the customer has made no, or very little, effort to improve their record keeping, we consider that a further sanction would, at that point, be appropriate. At present this represents 3 per cent of customers visited. This sanction is most likely to be a referral for a tax intervention to check previous returns for accuracy. However, in some extreme instances, a penalty at this stage might be appropriate.

² PaceSetter is an HMRC change programme which uses Lean tools and techniques to re-engineer processes and remove waste

- 3.91 In all instances, if the visiting officers find customers whose records are so deficient that it is highly likely to have affected previous tax returns, or to affect subsequent ones, they would refer the business for a full audit visit. In those circumstances, if the audit finds that the returns are inaccurate, and that inaccuracy is as a result of inadequate record keeping, a record-keeping penalty would be charged in addition to any other penalty due.
- 3.92 The behavioural change expected as a result of BRC is forecast to last around two years. This is as yet untested, but it seems reasonable that customers will begin to revert to previous inadequate record keeping as the memory of the visit fades and business pressures take over. We consider that it is important, therefore, that there is a system in place to re-contact businesses whose records were considered to be seriously inadequate to maintain the necessary behavioural change. This contact should take place approximately two years after the follow-up visit. The contact could firstly be done by telephone, along the lines of the leverage questionnaire to check the current position of the business and the understanding of the customer. Those considered to be at risk of having fallen back to inadequate record keeping would be subject to a further BRC visit. If that visit concluded that the customer had reverted to keeping seriously inadequate records then the trader should be referred for a full audit of their returns in the intervening period. In extreme circumstances a penalty could apply.
- 3.93 It will be important that any application of penalties in all the instances set out above is proportionate. Further work is needed to determine a reasonable tariff for application of penalties for inadequate record keeping.

4. Recommendations

Recommendation 1. BRC should be amended to be a more tightly targeted compliance intervention, but set within a framework of additional education and leverage activity.

Recommendation 2. BRC visits should be scaled back while urgent work is done on setting up the new processes recommended below.

Recommendation 3. HMRC should develop a range of leverage interventions aimed at high-risk trader groups and designed to:

- educate customers in the statutory requirements around record keeping
- sign-post those who want help to the self-help or targeted-help options
- offer the possibility of a self-assessment questionnaire which could be sent back to HMRC to provide further information for their risk-assessment
- let customers know that they might be chosen for a BRC visit
- make clear the penalties available for inadequate record keeping and incorrect tax returns

Recommendation 4. HMRC should consult with the representative bodies to define clearly what constitutes 'adequate' records for the purposes of BRC. The guidance and training given to visiting officers should be amended as necessary.

Recommendation 5. HMRC should work with the representative bodies to agree the point at which inadequate records become so severe that the customer needs to be subject to a follow-up visit to check that improvements have been made.

Recommendation 6. A referral for a tax intervention should be made at the time of the follow-up visit if the customer, previously assessed as having seriously inadequate records, has made little or no effort to improve their record keeping. In extreme circumstances a penalty might be applicable.

Recommendation 7. If a business is referred for a full audit and it is found that tax returns submitted before, or after, the referral were inaccurate and that inaccuracy was a result of inadequate record keeping then a record-keeping penalty should be charged in addition to any other penalty due.

Recommendation 8. HMRC should introduce a system to re-contact customers whose records were assessed as seriously inadequate at the time of the first BRC visit. The contact should take place two years after the follow-up visit and could initially be by telephone. Those considered at risk following the telephone contact should be referred for a further BRC visit.

Recommendation 9. A customer who received a BRC visit two years after the follow-up visit and who is found to have reverted to having seriously inadequate records should be referred for a tax intervention. In extreme circumstances a penalty might be applicable.

Recommendation 10. Further work should be done to agree a reasonable tariff for the application of penalties for inadequate record keeping.

Recommendation 11. HMRC should compile a complete list of the record-keeping educational products available for businesses and the times in the life-cycle of the business at which they would be most useful and work with representative bodies and others to promote their use.

Recommendation 12. HMRC should work with the representative bodies to improve the record-keeping educational products available and to gain agreement that representative bodies will promote the use of the products.

Recommendation 13. HMRC should work with the Low Incomes Tax Reform Group and other agencies to ensure that good record keeping and other educational support is available to businesses.

Recommendation 14. HMRC should consider how to apply the work being done by the Cabinet Office to help design products to change behaviours in this sector of the SME population.

Recommendation 15. HMRC should revisit the BRC guidance and training to ensure BRC visiting officers are clear on the boundaries of the record keeping advice they should give customers.

Recommendation 16. The BRC programme should streamline the visit process, removing some of the current prescription and reducing the length of the questionnaire.

BRC Review Terms of Reference (ToR)

Sponsors: Richard Summersgill and Naomi Ferguson

Purposes of review

- To review the Business Records Checks (BRC) programme in the light of the overall policy objective of ensuring that business records meet statutory requirements and are sufficient to enable a correct and complete tax return to be submitted within the time limits.
- To examine whether BRCs are an appropriate way of achieving HMRC's compliance objectives.
- To make recommendations for change.

1. Introduction

Background

The BRC programme is part of HMRC's reinvestment plans for the current Spending Review period. Following a public consultation exercise on the format of BRCs from December 2010 to February 2011, testing of the concept began in eight locations in April 2011 and expanded coverage began in September 2011, expanding to a full complement of 120 full-time staff by November 2011.

BRC are real-time compliance interventions which aim to identify inadequate record-keeping in a population of taxpayers pre-selected by reference to higher risk. Based on results so far, HMRC conclude that 40 per cent of taxpayers in the selected higher-risk group have inadequate records, and of that number 11 per cent are seen as having seriously inadequate records. The plan was to undertake 12,000 BRCs in 2011/12.

Penalties may be charged by HMRC where it is shown that businesses have not kept or preserved certain records, but the legal basis for these penalties in the context of BRC is disputed and at present these are not being deployed except in the most extreme cases. No such cases have been identified to date.

2. Objectives

The objectives of the review are to:

- evaluate whether the current programme is fulfilling its objectives in line with the Impact Assessment published in December 2010
- evaluate the effectiveness of the pilot compared to the costs and benefits set out in the Impact Assessment
- evaluate the policy objectives by reference to the business burdens imposed and taking account of the Government's growth agenda and the current economic climate
- consider whether BRCs are the most appropriate way to achieve the policy objective
- consider whether further work should be done with the representative bodies and others to:
 - identify the role that tax agents play in the record-keeping process and the work they undertake to ensure that taxpayers are able to submit a correct and complete tax return
 - provide guidance to businesses and advisers about what minimum records are needed in order to satisfy the legal requirements
 - improve existing knowledge and understanding of the role played by records in ensuring that a tax return is correct and complete
- make recommendations on the future direction of the programme

3. Scope and Method

Reviewers

The review team will be headed by Tracy Kirkham. She will liaise as necessary with:

- the review's sponsors
- the HMRC BRC team
- members of the compliance reform forum and the representative bodies;
- the wider SME community through the Administrative Burdens Advisory Board;

Scope

The Review should be wide-ranging and strategic in scope. Without seeking to restrict the nature of the review, the scope should include consideration of:

- the strategic challenges in addressing inadequate record keeping in key HMRC customer segments
- how effective are BRCs in addressing those challenges and how effective have they been in addressing the key issues
- whether the record keeping guidance provided by HMRC needs revision
- the wider public policy considerations underlying BRCs and the extent to which HMRC needs to work with stakeholders to achieve the desired policy outcomes
- the reputational risks associated with BRCs and consideration of alternative strategies to reduce risk
- how the support of the representative bodies could be harnessed to help drive improvements in inadequate record-keeping
- other possible approaches and options for improving compliance
- options for change and improvement

The review will **not** cover:

- the issue of legislative cover for BRCs (this is being separately considered as part of work already commissioned)
- the effectiveness of the training offered to the officers undertaking the checks (this will be considered as part of the evaluation of the test and learn activity)
- the extent of record keeping failure which would lead to a penalty and the legal basis on which a penalty may be raised (this will be considered as part of the evaluation of the test and learn activity in consultation with the representative bodies)

4. Reporting and deliverables

A draft findings report will be prepared for the sponsors by 10 January 2012 and this will be reviewed and refined for final agreement by the end of February 2012.