

Knock, knock

Contributed by Keith M Gordon
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As every child knows, the words 'knock, knock' should be answered with the question 'who's there?'. If the reply comes 'HMRC', however, a child's further response might differ from that of an adult. As the following article shows, the sight of an HMRC officer at the door will become an increasingly common occurrence and it will then become clear that, despite the title of this article, HMRC's new powers are no joke.

From a date to be appointed, HMRC officers' powers to inspect premises will be governed by FA 2008, Sch 36 and, in particular Part 2 (paras 10 to 14) of that schedule.

In this article, paragraph numbers will be references to paragraphs of Schedule 36, except where stated. What may be inspected?

Schedule 36 Part 2 is headed 'Powers to inspect businesses, etc'. and para 10 (the paragraph providing the main inspection power) is worded in a similar way.

Casual readers will therefore be forgiven for thinking that the Government has backed down from its original intentions to permit inspections of all premises (including residences).

However, the new legislation does not mean that private homes cannot be visited under the powers in Sch 36. This is because, while para 10(1) provides that an officer of HMRC may enter (only) 'a person's business premises', sub-paragraph (3) provides that this phrase means:

'premises (or any part of premises) that an officer of Revenue and Customs has reason to believe are (or is) used in connection with the carrying on of a business by or on behalf of the person.'

Thus, to give the definition its broadest possible meaning, if a person carrying on a business sits in bed one morning and looks at or responds to the e-mails that have come in overnight, then that person has used the bedroom in connection with a business, and the bedroom (at least) becomes susceptible to a visit.

At the recent Wyman debate, I asked those present which of them worked from home, occasionally or more often. Well over 90% admitted that they did: consequently, a considerable number of homes would seem to come within the definition of business premises.

What about the handful of those present who did not raise their hands in response to my question? Perhaps they genuinely do not use any part of their homes in connection with the carrying on of a business. Or perhaps they did not wish to admit the fact in front of those HMRC representatives present that evening.

In either case, however, again taking the legislation at its broadest, given that such an overwhelming majority of their peers do admit to working at least a bit from home, an officer of Revenue and Customs might have reason to believe that such individuals too are using their homes in connection with the carrying on of a business.

If that is the case, then they too might encounter a knock at the door. Home sweet home

Paragraph 10(2) provides that an inspection may not cover any part of a premises that is used 'solely as a dwelling'. If I were representing a taxpayer whose home was subject to a proposed visit, I would argue that this sub-paragraph provides a valuable exemption for taxpayers.

In particular, I would argue that, as is increasingly common with technological advances and a greater awareness of environmental concerns, a dwelling may be used for business purposes, but such use is wholly incidental to the premises' real function as a dwelling — an argument that I believe would be supported by many domestic insurance policies.

Consequently, the occasional (or even regular) checking of e-mails, updating of documents or making of a telephone call while at home should not expose the home to the risk of an inspection.

On the other hand, I would expect HMRC to argue that such business use (even if minuscule) would mean that the premises are not used solely as a dwelling and that, therefore, para 10(2) is not in point.

Under that narrower interpretation, the scope of para 10(2) would be limited to those parts of the premises that are not

used for business purposes at all – perhaps the children’s bedrooms.

Undoubtedly, this will be clarified by the courts in due course; however, it is regrettable that the legislation is so uncertain. In the meantime, therefore, readers should be careful where they wander when they are on the telephone taking a business call.

When Sch 36 was ‘debated’ in Parliament, the Financial Secretary to the Treasury, Jane Kennedy, said that ‘it would be very unlikely that these powers would apply in that sort of example’.

To add salt to the wound, Ms Kennedy added that this rule of thumb will be included in the guidance, which of course, has no statutory authority.It’s not my business

For individuals who are not carrying on a business on their own account, it might be tempting to think that para 10 will not affect them.

However, a closer examination of para 10(3) will reveal that the legislation focuses on the assumed use of the premises and whether the premises are used by or on behalf of the person in connection with the carrying on of the business.

Although a narrower construction is definitely arguable – i.e. that the business must be carried on by or on behalf of the person – the extended definition of business discussed in the paragraphs below suggest to me that that reading of the provision would be harder to substantiate.

This too was considered in Parliament.

The Financial Secretary to the Treasury suggested that employees’ homes do not constitute business premises (Hansard, Public Bill Committee, 10 June 2008, col 598).

However, with respect to Ms Kennedy, it is not only the case that this concession appears to be inconsistent with the legislation, but more importantly the context of those comments seems to suggest that the only comfort being given by her was that an inspection into an employer’s premises will not be used to check the tax affairs of the employee – this is something that is now explicit in the legislation in any event.It’s not a business

Delving further into Sch 36, one realises that para 10 can apply also to individuals who would consider themselves as not engaged in a business. This is because para 60(1) extends the meaning of business to include the letting of property, the activities of a charity and the activities of a government department, local authority, local authority association or any other public authority.

So, if someone uses his or her living room to host a committee meeting for a charity with which he or she is involved, that living room then becomes susceptible to an HMRC inspection.

About the only valuable restriction conferred by para 10(1) is that premises (or a part of premises) that a person is believed to use for the purposes of a business may not be inspected for the purpose of checking someone else’s tax position, unless they too are thought to be using the premises for business purposes.Conditions for an inspection

Having considered where an inspection might physically take place, let us now consider the circumstances that must exist for the inspection to take place.The statutory conditions

Paragraph 10(1) provides the statutory basis for any intended inspection. Such an inspection may take place ‘if the inspection is reasonably required for the purpose of checking that person’s tax position’. Again, reading the statute literally, that does not give the taxpayer much comfort.

Furthermore, the legislation does not seem to require the target of any inspection to be related to a person’s business activities because, once premises are identified as ‘business premises’, para 10(1) permits the HMRC officer to inspect the premises.

So, returning to the facts of Example 1 and Jim’s alleged bank account, HMRC may enter any premises they believe that Jim uses in connection with the carrying on of a business and look to see if they can find evidence of this account, whether or not the account is thought to be used in connection with the business.The timing of any visit

Advisers who have become used to self assessment will be forgiven for thinking that inspections will be a mere extension of the rules relating to formal enquiries under that regime.

However, Sch 36 makes it clear that nothing could be further from the truth. While para 10 requires the inspection to be reasonably required for the purposes of checking a person’s tax position, that test is broadly defined. In particular, para 64 provides that it covers ‘any tax’ and includes a person’s ‘past, present and future liability to pay any tax’.

Thus, once the legislation comes into effect, HMRC could visit premises to check the identity of a bank account that a person might plan to open and which might pay him or her interest that will not be taxable until a future year. What's a tax?

The term 'tax', as used in Sch 36 is defined by para 63(1). It covers (as one would expect) income tax, corporation tax, capital gains tax and VAT. Under para 63(2), the term tax is defined to include any amount assessable or chargeable as if it were corporation tax.

But the term tax appears to be exclusively defined in para 63. Therefore, any other impost (such as stamp duty land tax) is not a tax as far as the schedule is concerned.

However, it ought to be noted that para 63(1) goes further and defines tax so as to include a tax of other European Community states and those countries with which the UK has entered into mutual enforcement arrangements under FA 2006, s 173.

So, under Sch 36, I could be liable to an inspection from HMRC in order for them to check (for example) my position concerning a future Bulgarian tax liability.

To the best of my knowledge, I have no liability to tax in Bulgaria; however, I cannot confess any knowledge of the Bulgarian tax code. And I certainly cannot say what my future liabilities to Bulgarian tax will be.

Nevertheless, HMRC will soon be allowed to inspect my business premises (as defined) in order to check up on my tax position there (past, present or future).

Furthermore, provided that it comes within the scope of the relevant international/European Community treaty, it appears that HMRC may use the Sch 36 powers to inspect premises for the purposes of checking a person's position with respect to the overseas taxes, even where the equivalent UK tax is not covered by Sch 36. And there's more

In the articles that will follow, I shall consider in further detail what HMRC ought to do before turning up at the door, what taxpayers and advisers can do when there is a knock at the door and what HMRC officers can and can't do if they do actually enter the premises.

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