



CHARTERED CERTIFIED ACCOUNTANTS

Article topic: Financial Reporting

June 2010

HMRC 'Hotspots'

The last article on HMRC 'hotspots' looked at five of the most commonly looked at areas by HMRC and also looked at how Revenue technical accountants assist inspectors during the course of an enquiry into a company tax return.

This article looks at some other frequently looked at areas by HMRC in the area of financial reporting.

Directors' Private Expenditure

Situations can arise where a company will meet the cost of certain private items (this is particularly the case with clients in the SME sector) – in particular motor expenses such as road tax. Be careful with these because the bookkeeper may not be aware that such personal expenditure should be included within the director's current account, as opposed to a charge against profit. In some cases the additional tax charge may only be minimal, but in others such as large one-off debits to the profit and loss, the additional tax charge and interest may be sizeable especially if the preparer of the financial statements has not scrutinised the overheads sufficiently enough.

Director's Report

Legislation requires a copy of the full financial statements to be sent to HMRC and under Section 415 of Companies Act 2006, the Directors' of a company are required to include a directors' report within the full financial statements. HMRC can (and do) reject a set of financial statements if they do not include a directors' report. For companies classed as small, the directors' report will usually just comprise the principal activity of the company during the accounting period together with details of directors who have served on the board during the accounting period. For medium-sized and larger companies, much more disclosure is required within the directors' report, such as a business review and disclosure of creditor days.

P11D Benefits

Enquiries into a company tax return will usually involve the inspector asking for a breakdown of various expense accounts. In some cases, these enquiries may reveal benefits being provided to employees which have not been reported on form P11D – for example fuel benefits.

It is also worth mentioning at this point that where car benefits have been disclosed on form P11D, the purchase price of the vehicle is sometimes used instead of the vehicle's list price.

VAT Returns

Clients who use computerised bookkeeping systems such as SAGE often use the incorrect VAT code in terms of classifying expenditure between zero-rated VAT and exempt VAT. It is often the case that items which are beyond the scope of VAT will be processed as zero-rated. Whilst this does not have any effect on the amount of VAT payable/refundable to/from HMRC, what it does do is overstate the net values of sales and purchases in boxes 6 and 7. Such occurrences could well be classed as a mis-declaration in the event of a compliance review.

Audit Exemption

Whilst HMRC do not deal with Companies House issues, in a number of cases companies have claimed exemption from audit even though they are not entitled to audit exemption because claiming exemption when not entitled is a breach of Companies Act 2006. Revenue technical accountants are well-versed in financial reporting and the Companies Act 2006, so claiming audit exemption when not entitled will not necessarily go unnoticed. Some practitioners claim audit exemption based on the '2 out of 3' size limits test (turnover, balance sheet total and number of employees). This test is to decipher whether a company is 'small' in the eyes of the Companies Act 2006. The test for audit exemption requires only 1 of the three limits to be breached so a company with no turnover but gross assets of £4 million will require an audit. Similarly, if the company is a member of a medium-sized group, despite being small at individual entity level, then this too will require an audit. Revenue accountants and Inspectors could well inform the client that an audit is, in fact, required which could be potentially embarrassing for the practitioner!

Research and Development Costs

SSAP 13 'Accounting for Research and Development' and IAS 38 'Intangible Assets' both contain the requirements in dealing with the accounting treatment for research and development costs. Both standards take the same stance: research expenditure is written off to the profit and loss account (income statement) as incurred; development expenditure is capitalised if, and only if, strict criteria are met (technical feasibility, intention to complete, sufficient resources are available etc). In some circumstances, companies write off expenditure which Revenue accountants consider to be Development expenditure and which meet the capitalisation requirements in SSAP 13 and IAS 38. Again if Revenue accountants deem the items written off to be of a capital nature, this will result in additional tax and penalties.

Associated Companies

As mentioned in my previous article, the related party disclosure in the full financial statements can often tell inspectors whether the corporation tax limits have been scaled down appropriately to take into consideration the number of associated companies. For the purposes of tax, a company is an associated company of another at a given time if at that time:

- One of the companies has control of the other, or
- Both of the companies are under the control of the same person or persons.

For the purposes of tax, 'control' is defined under several headings:

- Control over the affairs of a company.
- Control through voting power.
- Control through share capital or through issued share capital.
- Control over income of the company.
- Control over the assets of the company.

Be careful with associated companies because the related party disclosure note can often be a costly disclosure.

HMRC Assistance

HMRC's new compliance regime now means it is more important to get the financial statements of an incorporated or unincorporated entity right to avoid penalties and interest being levied by HMRC. HMRC have recently introduced a range of toolkits which are designed to highlight the most common hotspots which attract HMRC's attention. The primary objective of these toolkits is to reduce the number of errors with the added intention of directing HMRC's attention to those who deliberately fail to pay the correct levels of tax.

Steve Collings FMAAT FCCA DipIFRS is the audit and technical director at Leavitt Walmsley Associates Ltd and a partner in AccountancyStudents.co.uk. He is also the author of 'The Core Aspects of IFRS and IAS' and lectures on financial reporting and auditing issues.