Practical tips for a tax audit

Eamonn Coates offers some practical advice for accountants whose clients face a tax audit

When Revenue intend to carry out an audit of a client's return or returns, they will give notice, generally 21 days, to both the client and practitioner. This letter will set out the scope of the audit, i.e., the taxes and years to be audited. It will also state the proposed date of commencement of the audit.

The first and most important matter to be discussed with a client, on receipt of a copy of the audit notification letter, is whether the client needs to make a prompted qualifying disclosure to Revenue in advance of the commencement of the audit. Once an audit notification letter has been received, the client cannot make an unprompted qualifying disclosure in relation to the matters within the scope of the audit. If a review of the client's tax returns – and tax affairs generally – establishes that there are tax underpayments resulting from non-compliance, Revenue should be notified of that within 14 days of the date of the Revenue audit notification letter so as to secure an agreed period of time (generally up to 60 days) in which to prepare and make a prompted qualifying disclosure. During this agreed period, the practitioner works with the client to quantify the amount of tax underpaid, along with statutory interest.

The qualifying prompted disclosure can then be presented to Revenue at any time before the audit commencement date, in writing, and must include:

(a) Background information relating to the matters giving rise to the disclosure along with a calculation of the tax and statutory interest;
(b) A declaration signed by or on behalf of the client to the effect that the disclosure is correct and complete; and,
(c) A payment of the tax and interest as calculated.

The quantum, if any, of penalties can be agreed at the conclusion of the audit with the Revenue auditor.

For the client, a qualifying disclosure will mean they will not be investigated by Revenue with a view to prosecution; they will suffer lower penalties; and details of the settlement will not be published by Revenue.

No loss of revenue

Another important matter to be considered when preparing a qualifying disclosure in relation to VAT or Relevant Contracts Tax is whether a 'no loss of revenue' (NLOR) argument can be made in accordance with the Code of Practice for Revenue Audit. If, based on the code, a practitioner can successfully make an NLOR case, he/she will achieve significant savings for the client. The tax underpaid will not be collected and only a relatively small penalty and, perhaps, some interest will be payable.

Other matters to be discussed with the client are the records which the Revenue auditors will require for review

at the start of the audit and suitable accommodation for the Revenue auditors.

If there is any doubt as to what records are required, the practitioner should contact the Revenue auditors to agree on what records will be available. In some cases, particularly where the client is a large business or organisation, a pre-audit meeting with the Revenue auditor might be arranged. Such a meeting can be beneficial to all parties as an understanding can be reached on what particular areas Revenue will target and the records/documents which they will require.

Where Revenue proposes to carry out a computer or e-audit, they will often suggest a pre-audit meeting to enable the Revenue auditor to familiarise him/herself with the client's IT systems. Any such pre-audit meetings are not a part of the formal Revenue audit process, and the client still has the opportunity to make a prompted qualifying disclosure at any time between any pre-audit meeting and the formal commencement of the audit.

Attendance

The Revenue audit is generally carried out on the client's premises. Suitable accommodation (i.e., a private room or office) should be arranged. At the commencement meeting, both the client (i.e., a sole trader or a designated company director) and practitioner should attend. If a prompted disclosure is to be made and has not been done before the initial meeting, it should be done at the meeting. This opening meeting should also be used to agree an outline work plan with the Revenue auditors and also to agree lines of communication. The work plan would include matters such as the length of time the auditors propose to spend on the premises, the records they wish to review, and particular areas they wish to focus on. It is very important to establish agreed lines of communication with the Revenue auditors for answering any queries they may have while they are on the client's premises. This line should be from the Revenue auditor to the client or financial controller. Revenue auditors should not ask questions of staff members generally, and staff should be instructed not to answer questions from the Revenue auditors, but to refer them to the agreed contact person.

Finalisation of audit

When the Revenue auditors have concluded their examination of the books and records, they will generally request a closing meeting to conclude the audit. Again, the practitioner should attend this meeting.

If a prompted qualifying disclosure has been made by the client and is accepted by Revenue as being complete, the question of penalties will need to be discussed. On the assumption that the prompted qualifying disclosure is the first made by the client, the level of penalties can range from 10% to 50% of the tax underpaid. Penalties do not automatically apply. Where the matter giving rise to the underpayment of tax was due to an innocent error and not to carelessness, no penalty applies. The practitioner's negotiating skills and experience in handling Revenue audits will be called into play in securing the most favourable outcome for the client.

If a prompted disclosure was not made and the Revenue auditors are satisfied that the return or returns are correct, they will say so, and effectively the audit will conclude at that point.

However, if Revenue has concerns and is of the view that there are undisclosed tax underpayments, the auditors will wish to discuss their concerns with the client and the practitioner. If, however, at the conclusion of negotiations, it is agreed that there is a tax liability, the client will be expected to make an offer to the Revenue, to include tax, interest and penalties. In cases where a qualifying disclosure was not made to Revenue, penalties can be as high as 75% of the tax underpaid. Again, if the matter giving rise to the tax underpayment came about due to an innocent error or is a technical matter, no penalty should apply.

In situations where a qualifying disclosure had not been made, details of settlements in excess of €33,000 will be published, where the penalty component exceeds 15% of the tax. A practitioner will achieve a significant benefit for the client if a penalty of 15% or less of the tax can be agreed.

In the case of cashflow difficulties, instalment arrangements can be agreed. For clients unlikely ever to be in a position to discharge the full liability, a reduced amount can be agreed. When a practitioner successfully guides a client through a Revenue audit, benefits for the client can include lower penalties and no publication of any settlement detail. For the practitioner, the benefit is a strengthening of the relationship with the client.

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