



# HMRC compliant expenses

Get tax compliant and maximise your VAT recovery

# Contents

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Overview	3
Why it is important to be prepared	4
What happens during a review	5
How to prepare for a review	9
Getting your expenses process right	11
In summary	14

# Overview

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Navigating the complexities of HMRC tax compliance is difficult for most businesses, regardless of industry sector or size.

Minimising the risk of compliance breaches whilst trying to effectively maximise VAT reclamation is the challenge.

One of the first places that HMRC investigate during a review is employee expenses so getting this right is essential.

The good news is that advances in technology mean there are ways to effectively manage your internal processes and ensure your employee expenses and VAT reclamation is compliant.

This expert guide aims to help you get prepared and confidently claim VAT on employee expenses without the fear of being caught out by HMRC compliance breaches.

You will gain practical advice on:

- [HMRC Employer Compliance Reviews.](#)  
Fully understand what HMRC are looking for before, during and post a review.
- [How to prepare for a review.](#)  
Be prepared and compliant in your policies and procedures for VAT reclamation.
- [How to get your expenses process right.](#)  
Improve your expenses process and ensure you claim back VAT correctly, prevent common mistakes and ultimately avoid HMRC compliance breaches.

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**“We recently had a full HMRC tax audit – our first in nine years – and we were easily able to demonstrate our full expenses process to the inspector. During this audit we had to sit and go through a lot of paper receipts and demonstrate all of our checks and balances to ensure they were accurate. With Selenity Expenses, that’s all done for me – we can go through an output report and show how the data is entered by claimants, and how the system enforces the rules to prevent fraudulent or incorrect claims.”**

*Mark Johnson,  
Payroll Manager,  
Leeds Teaching Hospitals NHS Trust*

# Why it is important to be prepared

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HM Revenue and Customs (HMRC) have been tasked with raising billions of pounds extra by HM Treasury without increasing taxes. To achieve these targets HMRC have dramatically increased the number of Employer Compliance Reviews that they conduct on employers, particularly focusing on small and medium employer's (SMEs) VAT compliance.

In selecting which businesses to review, HMRC have started a new initiative to help them focus their limited resources.

Instead of conducting routine on-site visits on all employers, which is manpower intensive, HMRC are initially requesting sight of an organisation's benefits and expenses policies. Irregularities in expenses reimbursement could then be the catalyst in deciding whether they then conduct a full review at your organisation.

## **So, how ready are you for this intense scrutiny?**

For SMEs with no expenses policies and checks in place, the risk of a HMRC review and a potential fine, is huge. A penalty could impact significantly on profitability and challenge the very existence of any business.

This has instilled fear amongst SMEs in claiming VAT incorrectly, so many choose to sit on the fence and not claim it at all. However, by not reclaiming any VAT on expenses, a business could lose significant amounts of money impacting their bottom line.

# What happens during a review

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A review by HMRC can be a massive upheaval for any business; whether they're small, medium or large. Finance Managers are required to demonstrate a fully compliant accounts system including proving each expense claim is legitimate, and policy is being adhered to in accordance with HMRC regulations.

Before we delve into how you can make sure your expenses processes are HMRC compliant, let's look at what to expect during a HMRC Employer Compliance Review (formerly HMRC PAYE & NIC inspection).

## HMRC review frequency

An Employer Compliance Review does not occur every year. The average time between reviews is usually six years. In a few cases, an inspection can lapse between 10 to 15 years; however, if your company have had past difficulties resulting in errors, a review can occur as frequently as once every three years. In addition, we have also outlined that they may decide to pick on organisations at random.

## Grounds for a review

Whilst there is no specific reason required for a review, there are a few trigger points that increase your chances of having your company inspected. These can include:

- Returning company cars without fuel benefit on P11Ds
- Forms P11Ds or P35 forms submitted late
- Information on submitted forms found to be incorrect
- HMRC having uncovered errors in similar businesses or industries
- HMRC gets a tip-off
- Regular mistakes on returns
- Numbers fluctuate by large margins
- Years of unprofitability
- Your figures are inconsistent with industry standards
- Directors earn less than employees

## Employer Compliance Review Notice

The first indication that you have been selected for a review is via a phone call. The HMRC Employer Compliance Officer will request a formal meeting with you to be held at your company's trading address or head office and will request that you are present. It is imperative that you always have professional representation with you. This is because your adviser will be more aware of precisely what the HMRC Officer is looking for and avoid common mistakes such as impromptu remarks regarding specific contractual arrangements during your meetings. Such comments can arouse suspicion and lead to a more in-depth, more thorough investigation.

## Confirmation letter

Once the meeting date is agreed, a confirmation letter from HMRC will be sent. In this letter, you will usually find that there is a request to review specific records. The records that are most commonly reviewed are:

- Payroll records
- Expense claims
- Cashbook and petty cash book
- Contracts
- IR35 policy and practice

If a request is made for copies of contracts, HMRC will be conducting a full IR35 review. You should begin to prepare for a robust defence and consider engaging expert representation if you are unsure whether you may fall foul of the IR35 rules.

## During the visit

The HMRC Employer Compliance Officer will check the following:

- PAYE calculations for completeness and accuracy
- Correct use of employee codes
- Reconciliation of the records with the P35
- Correct treatment of new employees and leavers (P46 procedures)
- Cash payments where PAYE has not been operated
- Compliance with sub-contractors' rules
- Compliance with NIC regulations
- Expense payments, employee benefits, and their correct disclosure on forms P11D or P9D
- Compliance with terms of any dispensation
- Problem areas

## Common problem areas

The following are the main areas where problems may arise:

- Gross payments to casual employees
- Private petrol payments
- Spouse's travel and subsistence
- Travel to work from home and vice versa
- Trips for purposes other than purely business
- Home telephone subsidies
- Entertaining
- Expenses for the use of home as an office
- Club subscriptions
- Work undertaken at an employee's home
- Medical expenses
- Casual labour
- Payments to alleged 'self-employed' persons
- Lump sum expenses
- Goods and services provided free or below market value
- Meal expenses and lunches in particular
- Clothing
- Accommodation

It is vitally important to thoroughly document which records are given to the Employer Compliance Officer to scrutinise. If they request any further information, make sure that this is submitted within 20 days of the visit. Your documentation of the visit should include what has been examined, the extent of the work, the findings, recommendations and conclusions.

## What happens post-review

Once a review has been completed the Employer Compliance Officer will explain what was wrong (if anything) and instruct you on how to satisfy the issue. In the case of significant inaccuracies, another visit might be in order. If your paperwork and presentation were in order and there was nothing found out of order, the Officer will tell you that the enquiries are finished and complete.

## What happens if any issues are found

If inaccuracies are found, the Employer Compliance Officer should tell you immediately. If HMRC says that your company owes taxes, they will try to reach an agreement during the visit.

Please remember that the Employer Compliance Officer is not always right and you are entitled to a formal explanation of the figures that they have calculated. You have the opportunity to dispute any findings, as well as have the right to be professionally represented doing so.

If (unusually) you agree with HMRC and are not prepared to challenge their findings you can make a payment on the account immediately, even if an exact figure is not set to avoid interest on any unpaid taxes.

## Assessments and Appeals

After negotiations, if an exact figure cannot be agreed upon or if there is not enough information available, HMRC can make an assessment. If you do not agree with this assessment, you will have 30 days to appeal. This appeal can be requested to be heard at a Tax Tribunal, and you have the right to supply the Tax Tribunal with the figures you believe are correct. The Tax Tribunal will then make a judgment based on both the figures and evidence presented to them.

## Settlement

The vast majority of compliance visits result in some discrepancies being uncovered, and HMRC will usually calculate the 'lost' tax and NIC over a period of six years plus the current year. This period may be extended if they suspect that deductions have been withheld deliberately. HMRC will often seek penalties, which will generally depend on the gravity of the discrepancy and the degree of co-operation and disclosure from the employer.

## Paying Interest and Penalties

It should be noted that HMRC can and will seek any penalties and interest if you fail to account for any tax, failed to make appropriate tax returns or have claimed excessive tax repayments. It should be noted that when a penalty is being calculated, the extent of the information provided, how helpful you were with the process and the seriousness of the issues are all taken into account..

**'The solution is really intuitive and user-friendly and it has simplified the expenses process for our people and the Finance Team. It has improved our HMRC and VAT compliance and the solution is flexible.'**

# How to prepare for a review

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Historically, HMRC conducted reviews for SME organisations once every six years, but we have learnt that this has become more frequent. HMRC is now more proactive with SMEs as some have never been audited before and perhaps have become laxer with their expenses and VAT reclamations; therefore there is potential for the HMRC to dish out more fines.

During a review, if HMRC find even just one incorrect expense item with an over claim of VAT, and they consider the reason for this is down to your organisation's culture, they may decide to multiply it by the amount of expense claims your company has had since its last audit; potentially up to six years.

Best case would be after a review, HMRC will ask your organisation to put more checks and procedures in place to prove that every single expense item and their corresponding receipts are being checked and approved thoroughly.

Many SMEs fear claiming VAT incorrectly, therefore are choosing to sit on the fence and do not reclaim at all. This is understandable; however, businesses are losing out on a significant amount of money. Allocate is currently working with a medium sized company, who identified that they have been missing out on £70,000 of VAT reclamation every quarter, through the fear of claiming incorrectly. Three years of not claiming is an accumulative total of an incredible £840,000.

To ensure you don't miss out on any amount of VAT reclamation, you need to be confident that the processes you have in place are HMRC compliant.

## There are two main HMRC recommendations that your organisation can adopt to ensure compliance.

- **Implement an effective expenses policy**

A robust expenses policy provides employees with a high-level view of what is expected and specifically guides the employee on what is and is not an acceptable expense for your company. A properly implemented policy can help save your organisation valuable time and resources, as well as helping to protect against fraud and compliance breaches. For practical steps on how to create an expenses policy that works – download your guide here.

- **Automate your expenses process.**

Improve compliance and be prepared for a HRMC review. Automating your expenses process will ensure there is a structured system in place to capture all the necessary information following HMRC regulations. This also ensures your company is compliant should you be selected for a review in the future.

In the next chapter we delve into the practical steps you can follow to ensure VAT compliance and how automating your expenses process with a digital solution can help you get it right.

# Getting your expenses process right

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Eight steps that you can follow to ensure that you are HMRC compliant.

## 1. Have a clear and enforced policy

Providing employees with a clear, concise and enforced expenses policy ensures they know what is expected. It also provides specific guidance on what is and is not an acceptable expense for your company, and in certain circumstances for their job role or department.

The policy must clearly state what can and can't be claimed and the cost limitations and reimbursement rules. An expenses policy also provides the practicality on to how claims can be made and your company's procedure of adhering to policy, processing an expense and monitoring the claims.

By implementing an expenses policy; all of your employees know where they stand, what they can and can't claim for and to what limit.

This reduces;

- The number of conflicts that can occur when an employee has an expense item which isn't approved.
- The time spent checking the expense and having it authorised by a Manager or accounts teams.
- The potential for low morale and poor attitudes that can occur as a result of conflicts. By having a policy in place, your employees claiming expenses will comply with not just your policy, but with HMRC legislation as well.

Using an automated expenses solution ensures that your policy is visible and accessible at all times whether the employees are on their desktop or their mobile, claimants know what they can and can't claim.

A digital system also allows claimants to upload receipts to claim expense items in line with your company policy which is attached to the expenses system. Any out of policy claims are flagged and allow the claimant to explain the reason for the approver to see; and either approve or return to the claimant for amendment.

## **2. Make sure you have an approval process that makes sense**

The approval process should be included within your expenses policy; advising the claimant the route their claim will take before its approved, who will authorise the expense item and when and how the expense will be reimbursed. This is to minimise any issues with claims regarding the amount they can claim and the duration in which claims are taken to be paid, for example.

This is made simple with a digital expenses system, with claims automatically being routed directly to the dedicated approver and approvers being able to approve claims on their smartphone, tablets and or desktop devices. Emails can automatically be sent to the claimant once a claim has been approved.

## **3. Advise on best practice for claimants**

There are several best practices that we advise you abide by to ensure that you will be ready for a HMRC review. Using an automated solution means you can capture this information easily using digital receipts.

- Have a receipt for each expense item claimed.
- Always ask for VAT receipt/invoice when making a purchase.
- Clear photo showing all information including not having fingers covering information.
- Ensure the date claimed is the date the item was purchased; the HMRC are interested in the purchase/tax point date only.
- If making large purchases, ask for the company name to be included on the receipt/invoice at the time of purchase.

## **4. Checks and controls on your expense claims**

HMRC don't have any set rules around this point but do state that checks must be carried out on each claim. This can be very manual and time-consuming for approvers, therefore a key reason why businesses are choosing an automated solution.

Flags and alerts can be set up for claims against policy; for example, a hotel which is over the total allowance for a claimant. Also, an automated system can check for VAT numbers of receipts; then each receipt is checked for compliance to your policy, date of claim, that the mileage claims have been verified against a route planner and the journey was a legitimate business journey.

## 5. VAT compliance

Should an expense item be recorded as an employee benefit, entertainment or business travel and subsistence? If claimants get this wrong, you will not be reclaiming full VAT, and you could be risking fines of over £100K if you cannot prove that the expenses claim played a legitimate role in the conduction of business!

Make sure you collect those VAT receipts. You must provide evidence that the VAT that is being reclaimed was due to a business expense and that the activity occurred. Approvers should reject all claims where a receipt has no VAT number unless a valid reason is provided. This can also be set as a flagged item within an automated system.

An automated solution can ask the claimant simple questions in a logical order to ensure the claimant can easily provide the essential information and determine if the item is VAT applicable or not.

Essentially, an automated expense solution provides a huge help in getting this vital process right, with compliance facilitated at every step, ensuring all complicated claims are recorded correctly; to comply with your policy and legislation.

Without fear of getting it wrong, your organisation can fully maximise the amount of VAT to be reclaimed and capture the information required in terms of:

- Employee entertainment
- PAYE settlement agreements
- Minimising corporation tax
- Maximising UK VAT reclamation
- European VAT handling
- Personal incidental expenditure
- P11D reporting
- Self-assessment

## 6. Mileage claims

One of the biggest rules that claimants often overstate is mileage claims by rounding up.

Automated solutions can use accurate calculations; for example, using shortest or fastest routes to ensure the claimant isn't over claiming; this gives mileage to the decimal point.

Claimants can also have personal mileage reports on their login so if they have to do a personal VAT return that information is available at their finger tips.

## 7. Secure payment process

You must show that your payment process can't be tampered with. Think about how many human touch points you have within your expenses process, are people open to bribery/fraud or do you have too many people with access to the export/output?

## 8. Have the correct documentation to hand

HMRC require evidence for each expense claim, and you need to document a valid business reason for each expense item. Receipts, invoices, purchase order numbers and travel bookings are just a few of the many examples you can show as evidence.

Many organisations have already brought into the benefits of cloud-based applications to help with their expenses. Claimants can use their smartphone camera to capture digital photos of their receipts as expenses occur which helps create a paperless process and helps minimise duplicate claims. Mobile expenses software also allows for the capture of mileage, check claim statuses or even reconcile corporate card statements.

# In summary

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A HMRC Employer Compliance Review can happen at random to any business at any time. The majority of common problem areas are related to employee expenses.

Having a clear and concise expenses policy and processes in place means your employees claiming expenses will comply, with not just your own policy, but with HMRC legislation as well.

Get it right and make sure you:

- Understand your HMRC obligations.
- Implement a clear and concise expenses policy that your employees understand.
- Adopt a digital expenses solution that will minimise the risk of compliance breaches.

Get these things right and you will maximise your VAT recovery and take away the worry of being caught out with compliance breaches and potential fines.

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To find out more about any of the topics discussed in this report, please email: [marketing@allocatesoftware.com](mailto:marketing@allocatesoftware.com)

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