Revenue Contractors' Project

Irish Tax Institute

Submission

11 November 2013

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Executive Summary

The reason for making this submission is that hundreds of compliant taxpayers are currently involved in the Revenue contractors' project and are incurring significant compliance costs. They are worried about the impact this is having on their business and are feeling significant confusion and stress as a result.

It would appear that a small number of contractors have over-claimed expenses and this matter should be tackled by Revenue. However, a range of serious practical issues, impacting on compliant taxpayers has now developed with the roll out of the current project on contractors.

We have collated a number of real life case studies from our members across the country (below), which we believe will give a good understanding of the difficulties being faced.

1. **Revenue had previously given a clean bill of health to many contractors**
   Many contractors were claiming travel expenses on the basis of mileage incurred. However, there were some who applied a rule of thumb on un-vouched expenses that was common in the industry. There was no dishonesty involved in this conduct and in fact, Revenue had actually audited a number of these cases. The same cases are now subject to Revenue's new regime applied on a retrospective basis.
2. **Bona fide travel expenses are being disallowed**
   Travel expenses are being treated as disallowed in situations where employees would be entitled to the reimbursement of the same expenses tax free. Revenue is also seeking a penalty for deliberate behaviour in these cases, in addition to tax and interest for 4 years**.**
3. **Genuine salary expenses are being disallowed**
   In many cases, Revenue is seeking to disallow the salary of a spouse working in the business and paying PAYE on their salary.
4. **Guidance on foreign travel and subsistence is contradictory**
   Revenue's guidance in Tax Briefing No. 3/2013 appears to contradict the guidance issued in IT54 as regards foreign travel and subsistence.
5. **Inability to pay is a real concern**
   The combination of the high penalty for deliberate behaviour and the 4 year audit period means that inability to pay is a common issue.
6. **Inconsistent treatment of taxpayers is taking place**
   Lack of consistency in the approach to cases between Revenue districts and regions, is giving rise to confusion and delaying agreement of settlements. The case studies below highlight inconsistencies that are arising under the following main headings:

   1. The number of years under audit
   2. Expense deductions
   3. Salary of spouse
   4. Penalties
   5. Making a disclosure
   6. Who is being audited

What is the profile of the contractors in this project?

Professional engineers and IT specialists are a key resource working for the multi-national sector in Ireland. Some are employed directly by the multinational companies, some are self-

employed individuals and others are employees of companies that contract with the multinational(s). This model has been in place and has been relatively unchanged for the past 20 years.

The personal profile of these taxpayers is giving rise to particular hardship in a number of cases and distinguishes this project from previous major projects where wealth or savings may have been available to meet the tax liabilities due.

- These are relatively young workers and often the main provider in the family - the majority are in their thirties and early forties with young children and high levels of personal debt.
- The settlement amounts arising are very substantial. The settlements amounts range from €30,000 to €160,000 and these high amounts are due, in no small part, to the interest and "deliberate behaviour" penalties being sought by Revenue over a 4 year period.
- The age profile of the contractors and their other onerous financial commitments means that inability to pay is a common issue in these cases.
- The position is so serious for some contractors that they have been forced to give up their roles and try to seek other work at this stage.

What is the reason for the urgency?

Hundreds of audits and other interventions involving contractors are currently open and awaiting resolution. In addition, many more contractors are unclear about their tax status and unsure as to whether they need to make, or should be making, a disclosure.

The pay and file deadline is almost upon us and people are feeling the pressure to get clarity on the situation and bring matters to a practical conclusion before another set of tax returns are filed.

The roll-out of the project to date

In late 2012, Revenue began a pilot project checking the tax position of a number of contractors and their companies "where the main source of income is a contract or contracts "for service" with a larger company or companies (directly or through intermediaries)". Revenue discovered that some individuals had been claiming un-vouched expenses and concerns arose about the understatement of tax that could arise. A wider project was therefore launched in the South West region in January 2013.

Early stages of the project

The key features of the project, as set out in Revenue's letter to the Institute of 22 January, were as follows:

1. The project began in the South West but we were advised that similar enquiries would be rolled out to other regions.
2. Revenue required under-declarations to be made on the basis that deliberate behaviour was involved i.e. a 10% penalty applied for unprompted disclosures, a 50% penalty for prompted disclosures and a 75%-100% penalty for failure to disclose or incomplete disclosures.
3. These penalties were to apply in all but exceptional circumstances and those exceptional cases had to be decided at Assistant Secretary level.
4. There would not be in-depth checking of disclosures where they broadly matched existing Revenue information or industry profiles.
5. Audits would cover the 4 complete years preceding the date of issue of the audit notice.
6. The issue of whether Revenue would seek to argue that the individuals were employees of the multi-national was not being considered at the time of the roll out.

National roll-out

By June of 2013, Revenue had rolled out the contractors' project to all regions. In the process, several key changes were made to the original outline plan:

1. In the East South East (ESE), Dublin and Border Midlands West (BMW) regions, contractors who did not believe they had to make a disclosure were required to produce all the books and records for the previous 4 years to Revenue's offices within 21 days.
2. The 4 year period was then changed to the specific years 2008-2011. In fact some inspectors are seeking to go back to 2007 and some are seeking to include 2012 in the audit.
3. The second director of the contractor company is also under audit in these cases.

The key issues

The Institute fully appreciates Revenue's responsibility to collect the correct amount of tax due for the Exchequer from contractors as it does with other taxpayers. However, in finding a solution to this situation it is important that:

1. Honest taxpayers are protected and compliance costs are kept to a minimum;
2. Taxpayers have clarity about how to deal with their position. Uncertainty about tax policy or the implementation of policy, creates difficulties and added cost for business, and
3. There is fair and consistent application of the law.

1. Protecting honest taxpayers

The Presumption of Honesty is enshrined in the Revenue Customer Service Charter. It is a cornerstone of our law and a fundamental principle of the Code of Practice for Revenue Audit, which provides all taxpayers with the right to have their cases dealt with on the basis of their individual facts and circumstances.

It may be that some contractors have acted dishonestly. The Institute is not in a position to either know whether this is correct, or the extent to which it is true. Therefore we are not in any position to comment on it. However, this does not change the fact that the majority of contractors have acted honestly in their dealings with Revenue even if Revenue now do not agree with the position they have taken in the past on expenses.

However, from the outset of the project, Revenue's instruction has been that all disclosures must be made on the basis that the contractor acted deliberately.

> *"Because of the nature of the under-declaration, we take the view that the provisions of the Code of Practice for Revenue Audit require us to regard the under-declaration as stemming from deliberate behaviour"*

Revenue guidance on expenses that was in place in the form of Statement of Practice IT/2/07 (Tax Treatment of the Reimbursement of Expenses of Travel and Subsistence to Office Holders and Employees) and IT 54 (Employees Subsistence Expenses) did not deal in any detail with complex issues such as "temporary place of work" and "normal place of work" and some contractors applied a rule of thumb on un-vouched expenses that was common in the industry. There was no dishonesty involved in this conduct and in fact, Revenue had actually audited a number of cases where un-vouched expenses were agreed up to certain limits. As recently as March 2013, the Certified Public Accountants reported Revenue's position as told to them:

> *"Revenue has suggested that as a guideline, valid expenses and costs of administration would reduce contract income by less than 20%"*

In terms of Revenue's administrative processes in dealing with the contractors' project, there may be efficiencies in treating all taxpayers prima facie as deliberate defaulters. However this is unfair for the majority of taxpayers. Revenue's approach does not appear to take account of section 1077E TCA 1997 and the relevant sections of the Code of Practice for Revenue Audit.

2. Clarity for taxpayers

After the Institute/Revenue Joint Conference in June, the Institute submitted a request to Revenue for clarity on a number of home to office scenarios. Some of these scenarios had been accepted by Revenue in the past as allowable and some had not. The request for clarity was to ensure that our members knew Revenue's views on which expenses were allowable and which were not. In the Tax Briefing that followed (No.3/2013), **none** of the scenarios that included any element of travel from the person's house were allowed, even in situations where the person genuinely had their office based in their home. Furthermore it seemed that travel and subsistence costs incurred on overseas assignments was also to be disallowed (in contradiction with the IT 54 position)

I attach a copy of the submission that we made on this Tax Briefing No. 3/2013 on 14 August past. We understand that a response from Revenue on this is due in the coming days.

In finding a resolution, this expenses position does not seem to us to be a practical way of dealing with contractors or other taxpayers who undertake significant travel both within Ireland and overseas. They should be afforded a similar regime on travel as employees and others who are entitled to tax free reimbursement of travel expenses and who get "country money" etc. Neither is it the way that taxpayers in similar situations are dealt with in other jurisdictions such as the UK.

A lack of clarity also arises because many of these contractors have agreed expense deductions in the past with Revenue and some contractors have been allowed to deduct a portion of expenses even under the current project. This lack of clarity is particularly urgent as it is hindering the preparation of disclosures under the current project and creating uncertainty about the 2012 position as people file their Pay and File returns.

3. Fair and consistent application of the law

One of the key issues that our members have asked us to raise with you is the matter of inconsistent treatment of cases between individual inspectors, districts and regions. While this may benefit certain taxpayers in the short term, it creates confusion and a sense of unfairness amongst others.

In our case studies attached, we have gathered a number of examples of inconsistent treatment that are arising on the ground and which are contributing to the sense of confusion that exists.

The role of TALC to date

The Institute is committed to the TALC process as a forum for discussing major Revenue projects and initiatives in advance of their roll-out. This has been very successful in the past in helping to identify upfront, practical issues and areas of uncertainty that might arise.

Unfortunately the roll out of this project was well underway before there was any opportunity to discuss it at TALC. The first discussion took place at Main TALC on 24 April 2013, 3 months after the initial roll-out of the project and was not discussed at TALC Audit until 11 June 2013 (by which time it had been rolled out in all but the Dublin region).

The Institute requested that the issue of contractors be included on the agenda of Main TALC for the meeting of 20 September. However, this meeting was cancelled as Revenue indicated it was not in a position to provide a meaningful discussion on the agenda items.

The issue was on the agenda of a Main TALC meeting held (via conference call) on 17 October 2013, and also on the agenda of a Main TALC meeting held on 7 November 2013. However, there was no substantive response from Revenue on the issue arising from the discussions at these meetings.

How to find a pragmatic solution

The Institute would like to have an urgent meeting with Revenue to discuss the contractors' issue. Ideally this would take place under the auspices of TALC. We suggest an agenda for the meeting that would include the following issues:

1. *Deliberate behaviour penalties*

   Every case should be judged on its merits in determining what level of penalty should apply. To do otherwise is inconsistent with the Code of Practice for Revenue Audit and the law. A penalty for deliberate behaviour is not appropriate to all cases and taxpayers should be entitled to make their disclosure on the basis of their own circumstances rather than having to persuade the Assistant Secretary of the region that they are not deliberate defaulters.

2. *A pragmatic approach to expenses for contractors*

   The Institute does not consider the position set out in Tax Briefing No.3/2013 to be a practical approach to expenses incurred by contractors or anyone else operating in a modern working environment.

3. *Dealing with the inconsistencies*

   These include the number of years under audit, round sum expense deductions, salary of spouses, application of penalties, issues regarding the making of a disclosure, and the question of who is the subject of the audit.

4. *Inability to pay cases and getting closure*

   For all the reasons outlined above, there are a large number of inability to pay cases arising and these will need to be addressed in a pragmatic way.

Actual contractor case studies and issues arising

Issue 1 – Revenue previously gave a clean bill of health to the taxpayers

Contractors who were recently audited and given a "clean bill of health" are now subject to Revenue's new rules applied on a retrospective basis.

Case background and circumstances

Our members have told us about a number of cases where the taxpayer had a recent audit and was led to believe that they had no issues with their expense claims. In some cases these contractors did not make an unprompted disclosure earlier this year when they had the opportunity to do so. They believed that their treatment of expenses was acceptable because they had been recently given a clean bill of health following a Revenue audit.

Issue 2 – Bona fide travel expenses are being disallowed

In these cases, the individuals are genuinely incurring costs in travelling to different locations for work. These expenses are being disallowed when they would not have been taxable if the contractor was an employee.

Revenue is also seeking a penalty for deliberate behaviour in these cases, in addition to tax and interest for 4 years.

Case background and circumstances

Case 1

The contractor based in South West travelled from home to a pharmaceutical plant in the South West four days a week. He was required by his work to travel to Dublin to perform his work duties one day each week.

He did not claim expenses for the travel between his home and the engineering plant. He claimed travel expenses for travel between his home and the Dublin office once a week, in line with the practice in place for employees of the engineering plant.

He is now under audit and Revenue is seeking a penalty for deliberate default of 50% in addition to tax and interest on the expenses claimed for the four years from 2008 to 2011.

Case 2

This contractor is involved in providing project management services to companies in Ireland, UK and USA. His company has 3 sources of work:

1. The provision of consultancy services to a range of pharmaceutical companies in Ireland, Europe & Asia. This role involves:

    - Travelling to work with clients at their sites, with no fixed routine.

- Working on projects from a home office.
- Visits to the Head offices of the companies for meetings.

2. Acting as Irish agent for a European company. This involves installation, calibration and maintenance of equipment at client sites in Ireland
3. Consultancy services for certain products that are manufactured at Irish sites. Most of this work is performed at the home office.

He also provides consultancy services to companies in the US, which requires working at home and calling into meetings during normal US hours.

He has received an audit letter. His reading of Tax Briefing No.3/2013 is that any of the travel from his home office is not allowable, which is clearly an inequitable position for him to be in.

Issue 3 – Genuine salary expenses are being disallowed

Revenue is seeking to disallow the salary of a spouse working in the business and paying PAYE on their salary.

Case background and circumstances

A contractor company acts as an intermediary for a number of contractors (12+) for whom the company obtains project work around the country.

The spouse of the owner of the contractor company is heavily involved in the business, preparing invoices, billing and cash collection, yet Revenue is seeking to disallow the tax deduction for her salary.

The current project has also made it more difficult to obtain work for these contractors. If they cannot claim travel expenses, this cost of travel will have to be factored into their charge out rate to the contracting company. Instead of paying the increased cost of engaging a contractor, companies are sending their employees to the locations around the country.

Issue 4 – Guidance on foreign travel and subsistence is contradictory

Revenue's guidance in Tax Briefing No. 3/2013 appears to contradict the guidance issued in IT54 as regards foreign travel.

Case background and circumstances

Case 1

This contractor is working for one company in the South West. The nature of his work as a project manager means that he is required to travel to Germany regularly for 2/3 days at a time.

He had been claiming motor expenses on travel from his home to the Irish plant, and occasional subsistence when staying overnight in the South West. He also claimed his travel and subsistence expenses for his business trips to Germany.

A disclosure is currently being prepared in relation to the tax due on the travel expenses claimed from his home to the Irish plant and his overnight costs in Ireland.

His tax adviser has reviewed Revenue guide IT54. It seems quite clear that outward and return travel to a foreign location to temporarily perform the duties of employment may be regarded as a business journey. In addition, subsistence can be claimed where performing duties in the foreign location.

However, having reviewed Tax Briefing No.3/2013 it would seem that his foreign travel and subsistence might not be allowable. The adviser has contacted the relevant Revenue District but they will not provide any clarity as to whether the foreign element will be allowed. This makes it extremely difficult to finalise the disclosure and advise the contractor of his likely liability.

Case 2

This contractor is an engineer based in Dublin whose company has a contract with a large Irish company. His work requires him to regularly travel to Asia to install machinery in plants. He could spend a number of weeks or a number of months at a time in Asia, depending on the nature of the installation.

He has always claimed his travel and subsistence expenses for this foreign travel based on the guidance in IT54. He had an audit in the 1990s and was given a clean bill of health by Revenue on his expense claims. He has received an audit letter. He cannot get any certainty from Revenue as to whether he must now pay tax, interest and a penalty on these genuine expense claims.

Issue 5 – Inability to pay

The combination of the high penalty for deliberate behaviour and the 4 year audit period means that inability to pay is a common issue.

Case background and circumstances

Case 1

A contractor based in Tipperary travelled between Cork and Tipperary on a daily basis for 6 years, working on a number of short-term contracts. He claimed his travel expenses and subsistence when he needed to stay overnight in Cork. He genuinely believed that he was entitled to claim these expenses. After many years seeking full time employment he now has a permanent job in Cork.

Following a recent audit he has received an assessment from Revenue for €70,000, including interest and penalties. He does not have the resources to fund this liability. Revenue has told him that they will pursue him in a personal capacity for the tax bill if the company cannot pay the settlement due.

Case 2

This contractor lived in Kildare and worked in Limerick. During the working week he stayed in Limerick 4 nights a week and claimed subsistence for these overnight accommodation costs. He also claimed for his travel expenses to and from Limerick once a week.

He has received an audit letter. He approached a tax adviser to compute his likely liability for the years 2008 to 2011. He has been told that the tax, interest together with a penalty for deliberate default could give rise to a liability of €160,000. In practical terms he simply will not have the money to pay this bill.

Issue 6 – Inconsistent treatment

Lack of consistency on the approach to cases between Revenue districts and regions, is giving rise to confusion and delaying agreement of settlements.

The number of years under audit

- The four complete years preceding the date of issue of a notice of audit – original South West position (January 2013 letter to Institute from Revenue)
- The four years from 2008 to 2011 inclusive (project extended beyond South West, June 2013)
- 2008/2007 through to 2012 i.e. 5 years currently being audited in some cases in some districts
- 2 years rather than 4 years - instance in the Border Midlands West (BMW) region

Expense deductions

- Revenue suggested that as a guideline, valid expenses and costs of administration would reduce contract income by less than 20% - Revenue presentation to CPA in March 2013
- Nominal un-vouched expenses of €1,000 per €25,000 turnover (4%) are allowable in a disclosure, in addition to valid invoiced expenses – feedback from members is that some Districts are quoting this as Revenue's "general guidelines/a template"
- A contractor's TOTAL expenses (excluding accountancy fees) in a disclosure should not be greater than 4% of turnover – feedback to us from members about Revenue's position at a recent Revenue presentation to accountants.
- Some Revenue inspectors, when asked, have said they are not aware of any "4% rule" and you would be taking the risk of making an incorrect disclosure if you included such a claim in your disclosure.

Salary of spouse

- Salary paid to spouse only allowable up to €5,000 – feedback from some members re South West Districts.
- Some Districts raised no issues with salary paid to spouse.
- Any salary paid to spouse assessable on contractor – feedback to us from members about Revenue's position at a recent Revenue presentation to accountants.

Penalties

1. *When does the deliberate behaviour penalty not apply?*

- Some Districts are saying that the penalty for deliberate behaviour is to apply in **all** cases. Revenue indicated on rolling out the project that a penalty other than for deliberate default can be applied, but only with the permission of the Assistant Secretary of the Revenue region. It was indicated to us in some discussions earlier in

the year that there would be no 50% penalty where the **only issue** at play is whether travel qualifies as home to work

2. *What is the fact pattern to support a case for a lower penalty*?

- In some Districts it seems that a penalty for carelessness of 20% is being imposed rather than the deliberate behaviour penalty, if the original expenses claimed involve costs legitimately incurred. However, even within Districts this approach is not being applied consistently.
- Feedback from some members is that Revenue will only consider a penalty lower than that for deliberate default if you supply Revenue with the full 4 year's information, receipts and records.

3. *What is the process to make your case for a lesser penalty?*

- Some cases have indicated that a detailed written submission must be made to the Assistant Secretary of the region if you are seeking a lower penalty.
- In some cases where settlements were submitted with a 20% penalty Revenue has responded by indicating that they will recommend that the settlements are accepted but only if a 50% penalty is applied. Revenue has not reviewed the cases before taking this position.

Making a disclosure

1. Time limit for submitting disclosure

- Letters to contractors noted they had 14 days to make a qualifying disclosure. Revenue's own rules for audits set out in the Code of Practice for Revenue Audit allow a taxpayer have an extra 60 days to prepare a disclosure, once they **notify** Revenue within 14 days of the issue of the audit letter that they are making a disclosure.
- If not making a disclosure letters from the East South East, Dublin and Border Midlands West to contractors' requested submission of their bank records, receipts etc for 4 years to Revenue within 21 days. This did not feature in the SW project.

2. The volume of information required by Revenue to settle a case once a disclosure is made

- Members have noted that after a disclosure is made in some instances they have received a request for a huge amount of back-up information e.g. trial balance, 46G returns, all receipts and records etc. This can result in cases taking many months to reach resolution on a case.
- In other cases handled by the same members but dealing with other Districts or Revenue officials the disclosures made are accepted in good faith and a settlement is agreed promptly.

3. Who is being audited

- In the South West, the contractor company and the contractor/director were audited.
- When the project was extended beyond the South West all directors of the contractor's company were under audit and requested to supply back up to their Form 11 returns, e.g. receipts, records etc for 4 years. Cases have arisen in family situations

where a director would not be actively involved in the business yet required to provide all their information.