

ADVISING RESTAURATEURS: Jonathan Silverman and Maria Guida

explain how to prepare for HMRC's crackdown on tax evasion in the restaurant trade

The problem

It's never been straightforward advising the prospective buyer of a restaurant, snack bar or fast food outlet, because in so many cases one suspects that the client is relying upon 'sales figures' supplied by the seller directly to him and of which the professional advisers have no knowledge. Moreover they may not be supported by the accounts provided, yet that rarely seems to be a stumbling block for a buyer despite any words of caution given by the lawyer. However, a recent HMRC statement may well focus the client's mind a bit more from now on.

In the past, HMRC has targeted professionals such as doctors and lawyers, as well as high-risk cash businesses such as plumbers. Now, it's the restaurateurs' turn. With HMRC having already announced that it intends to increase the number of prosecutions five-fold, its intention to tackle tax evasion is imminent and real. That raises problems of lawyers advising on an acquisition to ensure that warranties and indemnities are carefully drafted, especially to protect a buyer against any prior misdemeanours.

In an attempt to recover about £7bn lost to the Treasury each year through tax evasion, and to raise additional tax revenues of £18bn by 2014/15, HMRC has set up a specialist task force including the Criminal Investigations Unit, Special Investigations and Local Compliance, to investigate the tax affairs of restaurant businesses. When acting for buyers, due diligence questionnaires should now expressly ask whether any such enquiries have been raised by HMRC or are pending or whether any circumstances exist which could give rise to such an enquiry.

It seems that HMRC has always had intelligence of wrongdoing but lacked the resources to investigate it. Now things have changed and, as part of the government's comprehensive spending review, HMRC is using £900m committed by Danny Alexander, the chief secretary to the Treasury in autumn last year, and, significantly, it is doing so in an economic climate where all businesses have had to make cuts and may be more likely to evade tax.

What to consider

We are told that HMRC has enough data and is in a position to compare the exact cost and profit margins, per meal, between businesses across the country. They intend to compare the profit margins of restaurants in the same areas, which may lead to a business being subjected to a tax investigation.

The initiative on restaurants will begin shortly in London with nine more sector focused task forces in 2011 and 2012, and more will follow in 2012 and 2013, leaving no doubt as to HMRC's determination to tackle tax evasion.

With that as a stated objective one wonders whether it will affect the price achieved by the restaurants, sandwich bars and the like if the probability is now of closer revenue scrutiny.

HMRC recognises that the restaurant trade handles a large amount of cash and their tax affairs are often complicated, even more so when casual labour and cash tips are taken into account. As a result, they are considered to be of high risk.

Having one set of books for one's own private use and another to present to the tax authorities may have been tempting to some operators in the past, but expect HMRC to investigate far more rigorously irregularities regarding PAYE, VAT and corporation tax, as well as the personal tax affairs and income of restaurant owners and staff.

Individual staff members should also be advised to declare their total amount of tips received as taxable supplementary remuneration.

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What to do

There is lots more therefore for lawyers to clarify when acting on either the acquisition and disposal in the restaurant sector, or indeed as an ongoing adviser to anyone operating in this sector.

An investigation by tax inspectors could have huge ramifications, not only on the financial liabilities of the owners and personnel, but also on the restaurant's reputation and commercial viability. This could have an even broader effect if the restaurant operates under a franchise agreement, when the entire network risks being sullied by a prosecution against an individual franchisee.

Restaurants have been known to close down in the past following inspections. HMRC may use the full range of civil and criminal sanctions including imprisonment and new legislation allows HMRC to name and shame the parties involved if the amount of tax evaded is more than £25,000.

This whole process risks dragging law-abiding and innocent individuals and businesses into stressful and costly procedures. The use of specialised revenue inspectors focusing on specific trades and industries is reassuring, to some extent, as it should prevent mistakes made by generalist officers. However, do not overlook recommending to clients operating in the sector specialist insurance cover against the legal and accountancy costs incurred in defending an HMRC challenge.

Consider with your restaurant clients avoiding any unnecessary impairments and to explore the possibility of making a pre-emptive disclosure to HMRC before 31 May 2011. A couple of hours assisting them in bringing their affairs into order would be time well spent.

While it may not immediately come to mind do not forget to raise with clients whether there are any offshore business or assets which would benefit from the Liechtenstein Disclosure Facility, which offers immunity from prosecution – but that's another story.



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