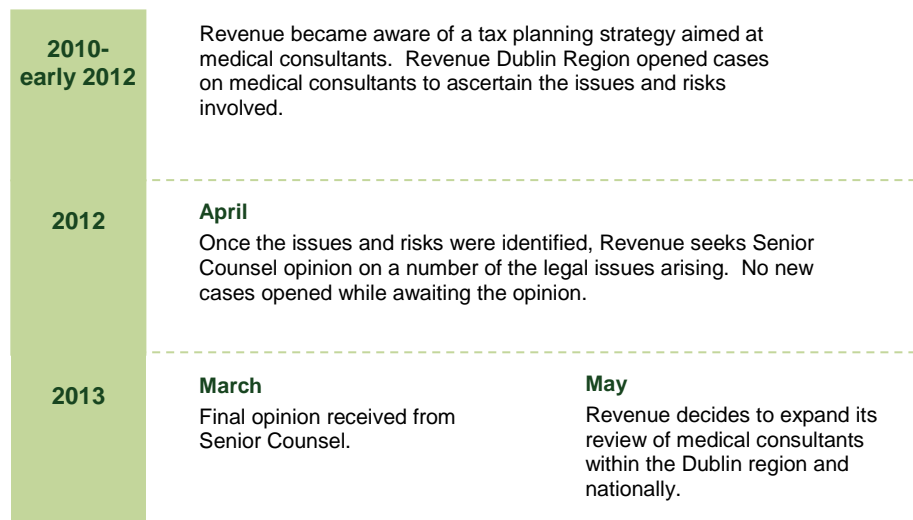


13 Revenue's Review of Medical Consultants' Tax Affairs

- 13.1** In 2010, the Revenue Commissioners (Revenue) became aware of a tax planning strategy that was being aimed at medical consultants. The strategy centred around the incorporation of a new company by the medical consultant and the transfer of his/her business (or part of that business) to the company. Revenue was concerned about the nature of the transactions between the consultant and his/her company and the evidence to support the commercial reality and validity of those transactions. Following an initial review of a number of cases in order to ascertain the issues and the risks involved, Revenue decided to expand its review of the tax affairs of medical consultants nationally.
- 13.2** Figure 13.1 sets out the timeline of events which led to Revenue's national review of the tax affairs of medical consultants.

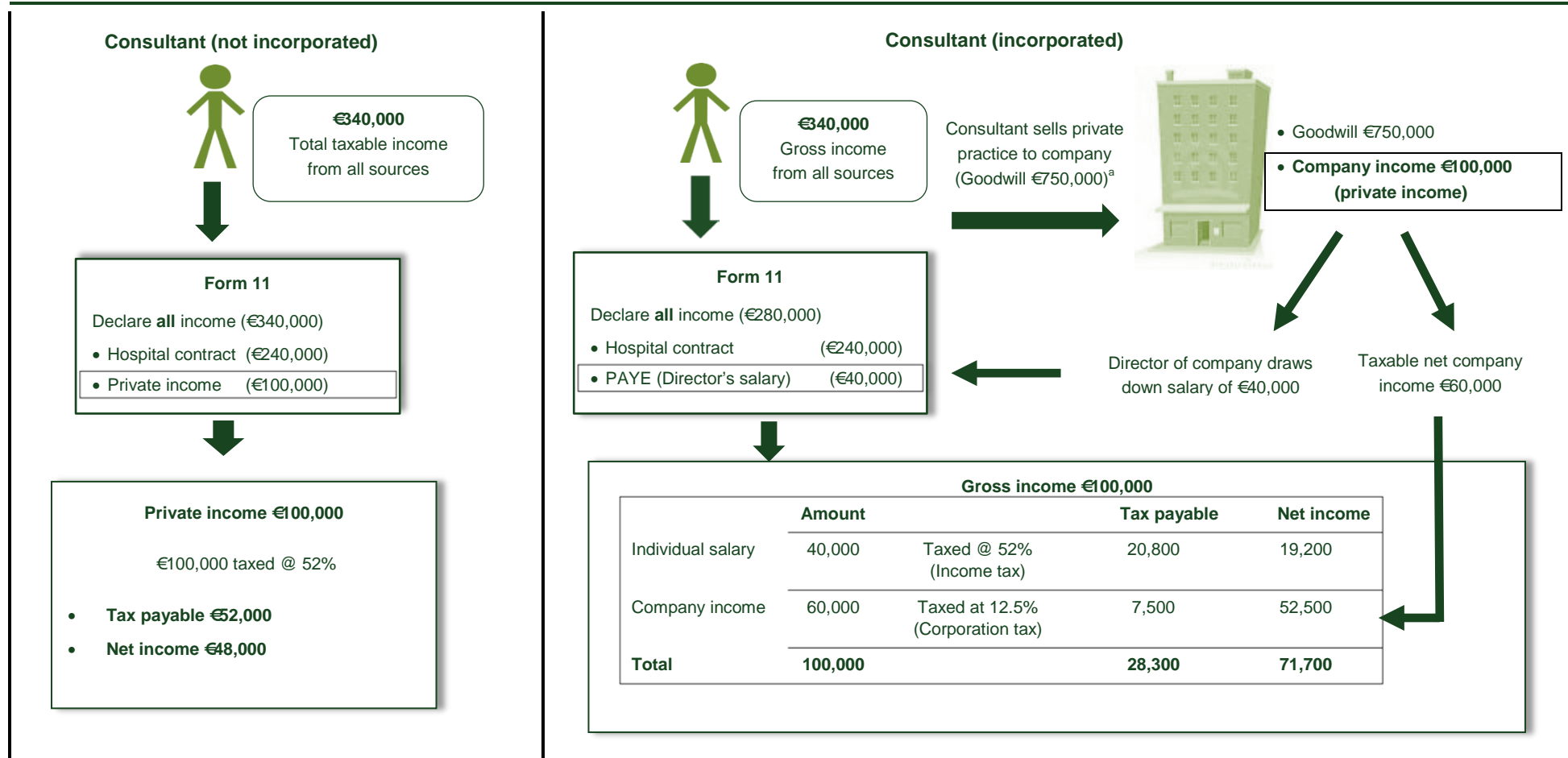
Figure 13.1 Timeline for Revenue's review of medical consultants



Source: Office of the Revenue Commissioners

- 13.3** This examination
- looked at the results of the interventions carried out by Revenue to date
 - reviewed a sample of closed cases to ascertain if a standard audit approach was being applied and
 - considered whether there was a clear recorded basis for the settlements reached in the cases reviewed.
- 13.4** Figure 13.2 shows how incorporation by a medical consultant affects his/her liability to tax.

Figure 13.2 Incorporation of a medical consultant's practice – illustrative example for a consultant aged 55 years (or over)



Source: Office of the Comptroller and Auditor General

Note: a When the goodwill is transferred it creates a liability to Capital Gains Tax, however, this liability is often offset in full using reliefs e.g. if the consultant is over 55 years of age, retirement relief can be used to offset the liability to Capital Gains Tax.

Types of interventions

- 13.5** The aim of Revenue's compliance programme is to promote voluntary compliance and deter non-compliance. Revenue carries out four main types of compliance interventions. When deciding on the type of intervention for a particular case, Revenue assesses the risk involved and decides which intervention would be the most efficient in terms of the time and resources available, while also addressing the perceived risk. The intervention types are set out in Figure 13.3. The figure also shows a breakdown of the interventions closed to 30 June 2016 as part of Revenue's medical consultants review.

Figure 13.3 Types of compliance interventions closed by 30 June 2016

| Type of intervention | Description | Cases closed in medical consultants review | |
|---|---|--|-------------|
| | | Number | % |
| Aspect query | A short, targeted intervention to check a particular risk. It can be carried out by telephone, secure email, letter or visit and escalated to a profile interview or audit, if necessary. | 190 | 47% |
| Profile interview | Revenue write to a taxpayer identifying the relevant risk areas. A date is scheduled for a profile interview at which the risks highlighted will be discussed. A profile interview can be escalated to an audit or investigation if warranted. | 31 | 8% |
| Audit | An examination of an individual's or a company's books, records and compliance with tax obligations in order to establish the correct level of liability. It may also involve collection of tax arrears. | 182 | 45% |
| Investigation | Where Revenue believes, from an examination of the information available, that serious tax or duty evasion may have occurred or a Revenue offence may have been committed, a Revenue investigation is carried out. It may lead to criminal prosecution. | – | – |
| Total number of cases closed at 30 June 2016 | | 403 | 100% |

Source: Office of Revenue Commissioners

Case selection

13.6 Revenue uses a number of ways to select cases for compliance interventions. One of the main methods used for selecting cases is Revenue's risk evaluation and profiling system (REAP).¹ REAP analyses available data and allocates a risk rating to each taxpayer which indicates the level of potential tax risk associated with that particular taxpayer. Cases are then prioritised based on the risk rating attributed by REAP which allows Revenue to target attention to cases posing the highest risk.

13.7 The risk rating is based on a series of business rules which are programmed within REAP. There are no specific rules built into the REAP system to assist with the selection of cases for the medical consultants review. In order to select cases, Revenue followed these steps

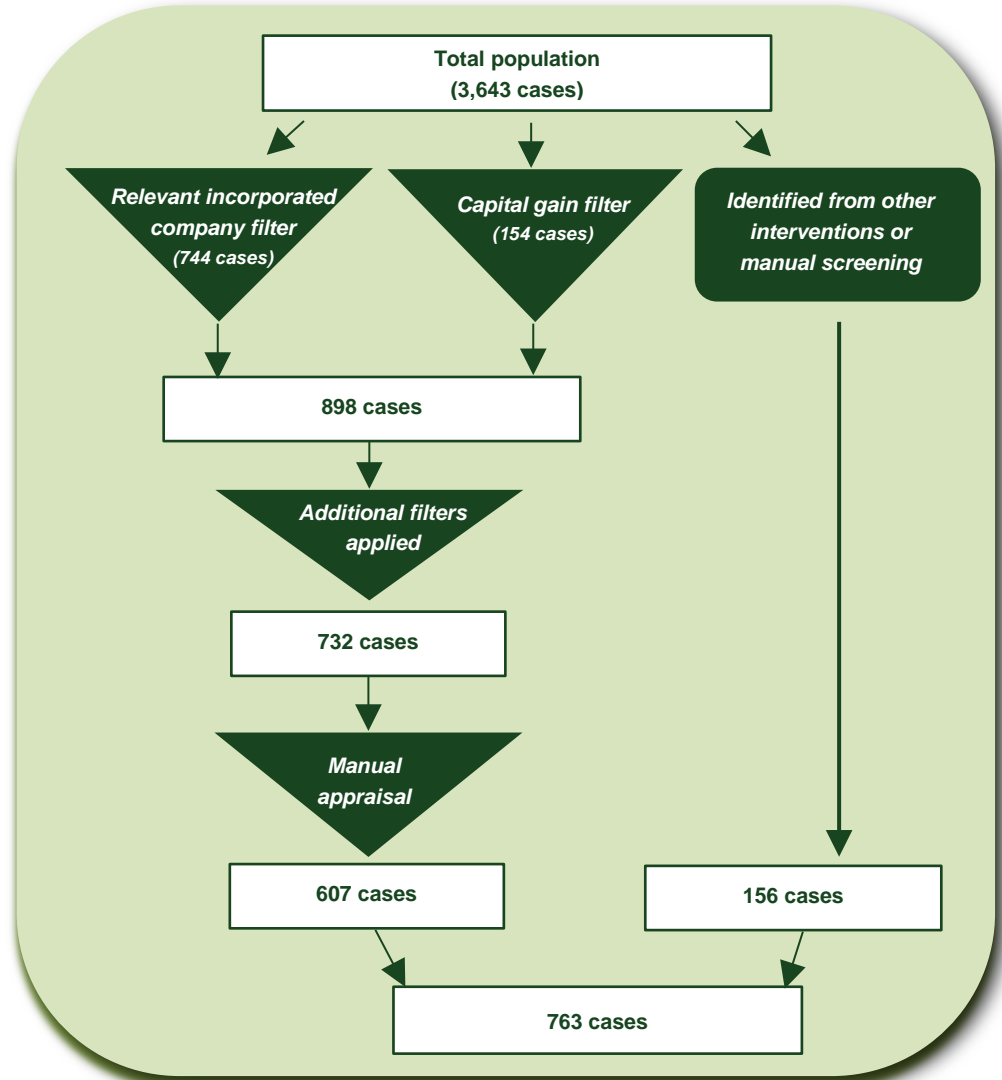
- First, a query was run in REAP to extract all registered taxpayers with a NACE code related to the medical profession that have an associated company.² This resulted in 3,643 cases and was regarded as the total population of possible cases.
- Those cases were then filtered to extract the consultants who had incorporated and/or reported a capital gain.
- The remaining cases looked at the amount of expenses being claimed and extracted cases where expenses exceeded certain thresholds.
- A manual review was then carried out which reduced the number of cases to 607.

13.8 In addition to this, a number of cases (156) were identified from focused manual screening or during other interventions that were being carried out. Figure 13.4 sets out the case selection process for Revenue's review of medical consultants' tax affairs.

¹ REAP is a computerised risk profiling system in use since 2008. It rates taxpayers, relative to one another, using Revenue's other systems as well as information from third parties such as the Health Service Executive, the Department of Housing, Planning, Community and Local Government and the National Transport Authority.

² A NACE code is a pan-European classification system which groups organisations according to their business activities.

Figure 13.4 Medical consultants review case selection process



1 **Future uplift** refers to the estimated tax receipts that have been saved or will be collected in future years as a result of carrying out an intervention. Revenue includes the amount of uplift in its reported yield figures. For the medical consultants' review, of the total yield of €48.7 million, €14.5 million relates to future uplift.

2 This refers to cases published in Revenue's list of defaulters to 30 June 2016. Additional publications may arise in the next publication based on cases closed to date. Revenue's list of defaulters is published quarterly.

Source: Office of the Revenue Commissioners

Outcomes to date

13.9 Revenue has initiated 763 medical consultant cases, 403 of which were closed by 30 June 2016, yielding €48.7 million, in tax (including future uplift), interest and penalties.¹ This yield relates to 235 consultants. 29 of the cases have been published in Revenue's list of defaulters.² Figure 13.5 sets out the yield, by region, from the 403 cases closed at 30 June 2016.

Figure 13.5 Yield from closed interventions as at 30 June 2016

| Revenue District | No. of cases | Tax | Interest | Penalty | Agreed settlement | Future uplift | Total Yield |
|---------------------------|--------------|---------------|--------------|--------------|-------------------|---------------|---------------|
| | | €000 | €000 | €000 | €000 | €000 | €000 |
| Dublin | 249 | 21,254 | 3,366 | 2,031 | 26,651 | 13,191 | 39,842 |
| East and South East | 25 | 550 | 135 | 45 | 730 | 270 | 1,000 |
| South West | 89 | 2,377 | 402 | 236 | 3,015 | 913 | 3,928 |
| Border, Midlands and West | 40 | 2,636 | 515 | 601 | 3,752 | 132 | 3,884 |
| | 403 | 26,817 | 4,418 | 2,913 | 34,148 | 14,506 | 48,654 |

Source: Office of the Revenue Commissioners

- 13.10** Of the cases closed, 70% resulted in the identification of additional liabilities. The average agreed settlement was approximately €173,000.

Issues arising

- 13.11** Revenue identified concerns, mainly about the following matters, arising from its review of medical consultant cases

- **goodwill** – the existence and/or validity of goodwill in the circumstance of each case
- **capital gains charges** – the transfer of the business by the consultant to the company gives rise to a capital gains tax charge which in some cases has been mitigated (sometimes in full) by the use of capital losses or retirement relief
- **non-business expenditure** – excessive deductions which include personal expenditure in many cases, for example, wages for under age family members and non-business related employees (e.g. nannies and housekeepers), personal motor expenses and travel costs
- **deferred income** – in some cases the inclusion of deferred income was often found to be unjustified and in others the amounts involved were often over-inflated
- **inter-agency transactions** – the company invoices the consultant for services provided (usually medical support or administrative services). Revenue is questioning the commercial reality of those cross charges.

- 13.12** Revenue recognises that 'goodwill' may exist. However, it has not accepted that goodwill arose in any of the cases closed to date. The Irish Hospital Consultants Association and tax agents have asked Revenue to publish guidance on the matter. In February 2016, Revenue established an internal working group to look at the tax issues arising from incorporation of professional practices (consultants, dentists, accountancy firms etc).¹ The group has not yet completed its review. Revenue stated that it intends to produce some general guidance on the matter when the review is completed.

¹ The purpose of the group is to examine the issues arising from the incorporation of professional practices and advise on the appropriate compliance response. The group comprises members from each region, the Large Cases Division and Revenue Legislation Section. The group is chaired by a member of the Planning Division.

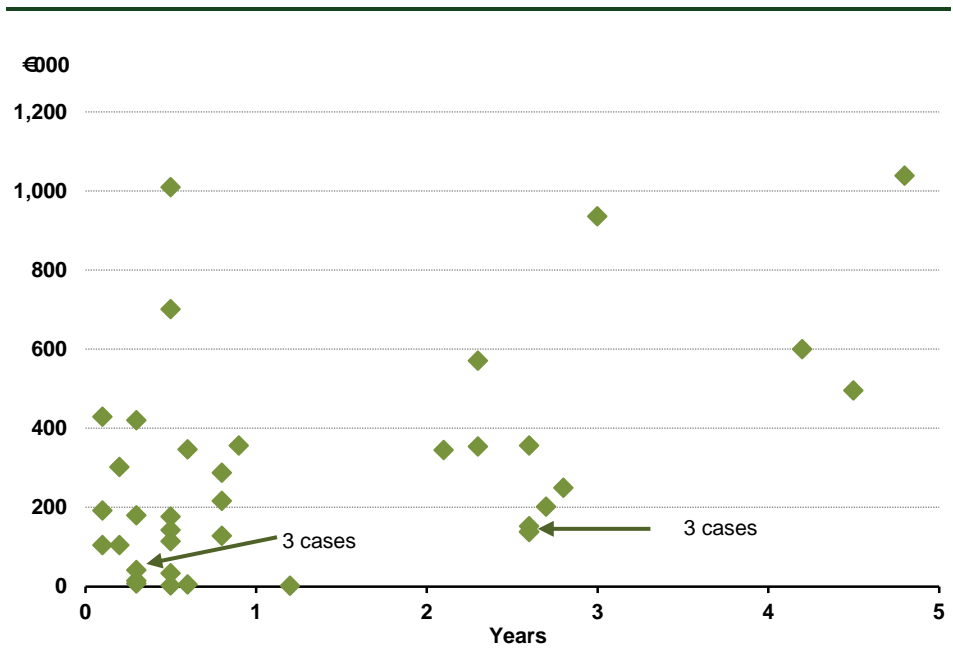
Review of cases

13.13 A sample of 37 closed cases was reviewed as part of this examination. The yield from the 37 cases totalled almost €8 million in tax, interest and penalties with a further €3 million recorded as future uplift. Overall, the examination team noted that a consistent approach was taken by Revenue when carrying out the compliance interventions in this area.

Timeliness

13.14 It was noted for the sample that the time taken to close the interventions varied. As shown in Figure 13.6, just under half of the cases (46%) were closed within 6 months of commencing while three high value cases took over four years to close.

Figure 13.6 Timeliness in closing interventions^a



1 Taxes Consolidation Act 1997, sections 1080 to 1084.

2 A qualifying disclosure is a disclosure of complete information in relation to a tax liability. There are two types of disclosure – 'prompted' which is made once a notification of audit has been received but before the audit starts and 'unprompted' which is made before a notification of audit is issued or before the commencement of a Revenue investigation.

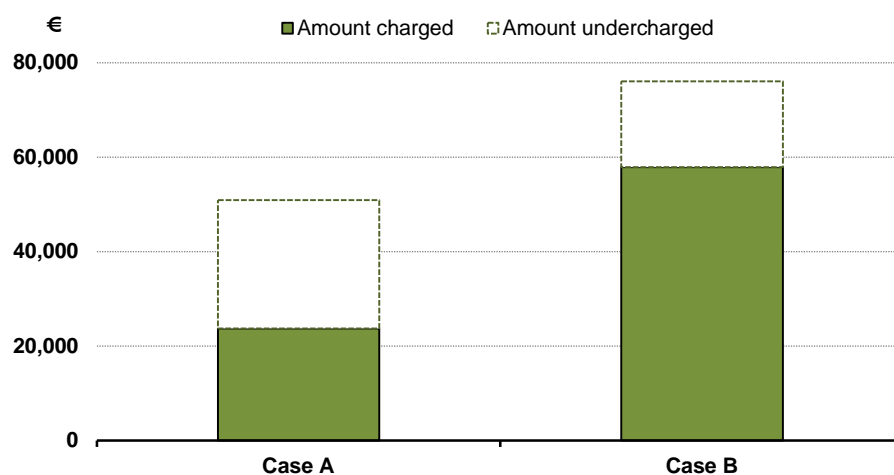
Source: Office of the Revenue Commissioners, analysis by the Office of the Comptroller and Auditor General
 Note: a The yield figures include future uplift.

Interest and penalties

13.15 The Taxes Consolidation Act 1997 provides for the application of interest for the late payment of tax.¹ There is no provision for interest to be mitigated even after a qualifying disclosure is made.² The rates of interest to be applied are set out in various Finance Acts. Penalties may also be applicable where tax returns made were incomplete or inaccurate and associated payments have not been made on time. The level of penalty is set out in Revenue's Code of Practice for Audit and Other Compliance Interventions (see Annex A).

13.16 As part of this review, the interest and penalty amounts charged were recalculated for ten of the 37 cases selected. Differences were noted in two cases. Figure 13.7 sets out the estimated amount undercharged (which totalled just over €45,000) as a proportion of the total interest and/or penalties due. The tax liabilities in these cases totalled almost €725,000. For one of the cases (Case B) Revenue deducted refunds due to the consultant prior to calculating the penalties. However, such a deduction is only permitted for refunds arising as a result of related events which was not the position in this case.

Figure 13.7 Results of the interest and penalty recalculation^a



Source: Office of the Comptroller and Auditor General

Note: a Case A refers to a miscalculation of interest and penalties, case B refers to miscalculation of penalties only.

Quantifying the liability due

13.17 The Revenue Code of Practice for Audit and Other Compliance Interventions does not specify that the Revenue auditor must quantify the liability due when carrying out an audit. The Code states that Revenue will *'usually ... advise the taxpayer of any errors, omissions or irregularities in the tax or duty returns submitted (including those in the taxpayer's favour), determine the tax liability if it arises, request settlement and specify any action that may be required to place the taxpayer on a compliant footing.'*

13.18 When a disclosure is made by a taxpayer, the taxpayer must state the amount of tax and interest due. Of the 37 cases reviewed as part of this examination, there were seven audits where no disclosure was made by the taxpayer. For these cases, the review would have expected to find that the Revenue auditor calculated the liability due.

- For three of the seven cases, Revenue advised that the Revenue auditor calculated the liability due. The calculations found on the case files were not signed or dated by the caseworkers, so it was difficult to identify that they were prepared by Revenue and not the taxpayer/agent.
- For the other four cases, the settlement was based on calculations submitted by the taxpayer's agent and verified by the Revenue auditor. Two of the cases related to negotiated settlements (see Cases C and D below). Even though the Revenue auditor is not required to calculate the liability due on completion of an audit, where it is not calculated by the Revenue auditor it is difficult to evaluate the offers being proposed by the taxpayer.

Settlements agreed

- 13.19** The review found that in two of the cases reviewed, a negotiated settlement was reached. Summaries of each case are set out below.

Case C

- 13.20** In this case, the consultant recorded fee income of just over €2 million in the related company financial statements over a period of six years. Because a bank account had not been set up for the company all fee income, including that of the company, was held by the consultant in a private bank account.¹ The 'company' fee income was recorded as income in the profit and loss account with a corresponding debtor on the balance sheet. The Revenue auditor was satisfied that the fee income was the consultant's own income and not company income following the Revenue audit.
- 13.21** As part of a negotiated settlement with the consultant, it was agreed that the consultant would be paid a significantly increased salary from the reported fee income which would be taxed at the relevant income tax rates, resulting in a large cash payment to Revenue. There is an expectation that the debtor recorded in the company balance sheet will be adjusted following the settlement and that any remaining balances will be taxed appropriately in future years.

Case D

- 13.22** In this case, the consultant recorded fee income of €1.2 million and pension deductions of €800,000 in the related company financial statements over a six year period. The fee income was recorded as income in the profit and loss account with a corresponding debtor on the balance sheet. The pension contributions were recorded as expenditure in the profit and loss account with a corresponding creditor on the balance sheet.
- 13.23** As part of a negotiated settlement with the consultant, it was agreed that a significant amount of the fee income and pension deduction balances recorded in the company accounts would be taxed at the relevant income tax rates, resulting in a large cash payment to Revenue. Similar to Case C, and as with any yielding Revenue intervention, there is an expectation that the necessary adjustments will be made to the financial statements in line with generally accepted accounting principles and that any remaining balances will be taxed appropriately in future years.
- 13.24** Adjustments to financial statements are required in subsequent years as a result of certain settlements agreed with consultants. However, details of these adjustments are not documented in the settlement agreements. As a result, Revenue is not aware if the adjustments required as part of the settlements agreed have been made. Revenue has stated that it intends to re-visit a sample of the cases where this has arisen to confirm that the relevant adjustments have been made.

¹ The company income was held in trust by the consultant for the company.

Approval of settlements

13.25 Revenue's formal approval levels for settlements are as follows

- Up to €50,000 – District Manager (equivalent to Principal Officer (PO) level)
- €50,001 - €100,000 – Assistant Secretary
- Over €100,001 – Revenue Commissioner

13.26 The Revenue manual states that *“in some districts, the responsibility for approving settlements under €50,000 may be delegated by the PO.”* The rules around how the delegation should be effected are not set out in the manual, nor is the delegation incorporated into Revenue's Case Management System.

13.27 Seven of the 37 cases chosen for review related to settlement amounts which were less than €50,000. As a result, they required District Manager approval, unless responsibility was assigned to another officer. Six of the cases had been approved at grades lower than District Manager level but there was no evidence to show that formal delegation had occurred. Five of the cases were approved at Assistant Principal level and one of the cases was approved at Higher Executive Officer level.

13.28 Since July 2013, when an audit settlement is approved, it can be automatically randomly selected and referred for further approval to Assistant Secretary or to a Board Member (including the Chairman of the Revenue Commissioners).¹ Where a case is chosen, it goes directly to the selected Assistant Secretary or Board Member and bypasses all other normal approval levels.

13.29 While the review noted that settlements arising following aspect queries and profile interviews can be significant, the random selection for further approval only applies to audit settlements. It does not apply to settlements agreed following aspect queries or profile interviews.

¹ A random audit approval algorithm is invoked to decide if the audit will be selected for further approval.

Conclusions and recommendations

- 13.30** In 2010, Revenue initiated a review of the tax affairs of medical consultants in the Dublin region following concerns about a tax planning strategy being promoted within the medical profession. Following review of a number of cases, Revenue was satisfied that the matter warranted further examination so the review was extended nationally in 2013. Revenue has opened 763 medical consultant cases, 403 of which were closed by 30 June 2016, yielding €48.7 million, in tax (including future uplift), interest and penalties.
- 13.31** A sample of 37 closed cases was reviewed as part of this examination. Overall, it was found that a consistent approach was applied by Revenue in carrying out those interventions. However, certain issues were identified where improvements could be made. Those issues are set out in the recommendations below.

Timeliness

- 13.32** As part of the review of the 37 cases it was noted that there was a significant variance in the time taken to close cases. Just over half of the cases (20) took over six months to close, with three of those cases taking over four years to close.

Recommendation 13.1

An internal review should be carried out of a sample of cases where significant variances in the time to close is noted. This review should identify both the cause of the delays and possible steps Revenue could take to avoid such delays in the future.

Accounting Officer's response

Part agreed. District Managers review the reasons for delays in closing cases by consulting regularly with audit managers. Following on from recommendations previously made in Chapter 27 (Tax Audit Settlements) of the 2012 Report of the Comptroller and Auditor General, quality assurance reviews are carried out frequently and have highlighted the need to further strengthen the controls around managing the duration of audits. These increased controls are being implemented. Metrics on the duration of audits have been included on the Revenue Case Management dashboard and are constantly highlighted and discussed at Regional/Divisional management meetings and at Business Management Executive meetings.

In relation to the specifics of the medical consultants programme, the nature of the engagement in these cases meant that negotiations and settlements were particularly protracted and their duration would exceed that of a normal audit.

Calculation of interest and penalties

- 13.33** As part of this examination, the interest and penalties for ten of the 37 cases reviewed were recalculated. Variances were noted in two of the ten cases. This suggests that Revenue's process for ensuring correct calculation of interest and penalties could be improved.

Recommendation 13.2

Revenue should review the procedures it has in place to ensure that interest and penalties are quantified in accordance with legislation and its Code of Practice. To assist with this exercise, a sample of interest and penalty calculations should be reviewed. Where variances are noted, Revenue should collate the reasons for the variances and communicate the findings to staff to ensure that this does not reoccur on other cases.

Accounting Officer's response

Part agreed. More frequent quality assurance reviews have resulted in steps being taken to ensure that lessons are learned from the small number of cases where there is a deviation from the legislation and the Code of Practice in applying interest and penalties.

Revenue's audit guidelines are regularly reviewed and updated and messages are disseminated through a variety of fora, including National Compliance Seminars, Regional Conferences, Regional Management Team meetings and Compliance Networks.

Quantifying the liability due and settlements made

- 13.34** Of the 37 cases reviewed as part of this examination, there were seven cases where no disclosure and no statement of the amount of liability were made by the taxpayer. For three of those cases, the Revenue auditor quantified the liability due. However, the calculation was not signed or dated so it was difficult to confirm that it was prepared by Revenue and not the taxpayer. For the other four cases, the settlements were based on calculations submitted by the taxpayers' agents. A quantification of the liability due by the Revenue auditor on completion of an audit would provide a clear basis for the settlement agreed.

Recommendation 13.3

Revenue should ensure that the auditor has assessed/quantified the liability due and that any settlement amount agreed below that is clearly explained and recorded in the audit report.

Accounting Officer's response

Agreed. The Revenue Case Management System is an essential part of the solution. Audit reports filed on the case management system should include clear explanations on how settlements have been reached. Planning Division will reiterate this message to staff engaged in compliance interventions.

Settlements agreed

- 13.35** In two of the 37 cases reviewed, negotiated settlements were reached but the full terms of the settlement agreements, in relation to subsequent adjustments to financial statements, were not formally communicated to the consultant. Revenue is not aware if adjustments required as part of the agreed settlements have been carried out by the consultant.

Recommendation 13.4

Revenue should ensure that all of the requirements of a tax settlement, including the necessity for any adjustments to financial statements, are formally communicated to the taxpayer in writing. Revenue should also ensure that it follows up on cases where subsequent adjustments are required as part of the settlement agreement.

Accounting Officer's response

Agreed. Revenue's Code of Practice for Audit and Other Compliance Interventions explains that we conclude interventions by issuing a final closure letter. Where, as a result of the audit, adjustments to financial statements are required, this will be communicated in the closure letter. Revenue expects that in line with general accountancy principles, these adjustments to financial statements will be made in the normal course of events. But Revenue commits to following up on a sample of such cases to ensure that the relevant adjustments have been made.

Approval of settlements

- 13.36** Revenue procedures state that the approval level for settlement amounts up to €50,000 is District Manager level. While Revenue stated that a District Manager may assign responsibility to audit managers, this process is not documented and it is not incorporated into Revenue's Case Management System.
- 13.37** As part of this examination, the settlement approval for the sample of 37 cases was reviewed. Seven of the cases resulted in settlements less than €50,000. Six of those cases, ranging in value from €2,000 to €33,000 were approved at grades lower than District Manager level, without any evidence to show that formal delegation had been applied.

Recommendation 13.5

Revenue should review the approval levels for settlement amounts. The approval level for amounts up to €50,000 should be incorporated into the Revenue's Case Management System. If delegation to grades below District Manager level is required for amounts up to €50,000, the procedures manual should be amended to reflect how this should be recorded and the amended approval levels should be incorporated into the Revenue's Case Management System.

Accounting Officer's response

Part agreed. In a very significant number of cases, the Assistant Principal Audit Manager will sign off on the audit based on assigned authority from the Principal Officer District Manager. Revenue is satisfied with the current approval levels for settlements but keeps these amounts under review. The various approval levels are already built into Revenue's Case Management system and reflected in the relevant user manual. Revenue will consider if the delegation of authority to approve settlements up to €50,000 needs to be formalised in other procedures manuals and elsewhere.

- 13.38** In addition to the normal approval procedures in place for settlement amounts, when an audit settlement is approved it can be randomly selected and referred for further approval at Assistant Secretary or Board level. This is a good internal control mechanism, but it only applies to audit settlements. It does not apply to settlements agreed following an aspect query or profile interview.

Recommendation 13.6

The selection of settlements for further random approval at Assistant Secretary or Board level should be extended to include settlements reached following aspect queries and profile interviews.

Accounting Officer's response

Not agreed. It should be noted that non-audit interventions go through the formal approval process in the same way as audits, except that there are no random referrals. As the number of non-audit interventions greatly exceeds the number of audits, the level of random referrals must be balanced with identified risks and available resources. The Revenue Board is satisfied with the current arrangements. However, a review of non-audit interventions will be conducted later in the year and the introduction of random approval for these interventions will be considered in light of that.

Project review

- 13.39** Revenue has closed 403 cases as part of its review of the tax affairs of medical consultants and there are 360 cases currently ongoing. There has been no formal review of cases closed to date. Such a review would assist Revenue in collating the findings from the cases closed to date, highlight the main risk areas and allow Revenue to communicate those findings and risks to the staff dealing with the cases of medical consultants.

Recommendation 13.7

Revenue should review a sample of closed cases in this project, and should communicate any lessons learned to staff.

Accounting Officer's response

Agreed. As with national programmes of a similar nature, learning the findings from the caseworking carried out and imparting these in a structured way is a very important part of the overall process. In this regard, the various internal communications channels like Divisional Management meetings as well as National and Regional Compliance networks play a critical role. A knowledge of the practices adopted by medical consultants is also relevant for potential reviews of other sectors/professions.

Annex A Penalty rates for defaults on or after 24 December 2008

| Qualifying disclosure | Category of behaviour | Full co-operation not given | Qualifying disclosure made – full co-operation given | |
|---|---|-----------------------------|--|-----------------------|
| | | | Prompted disclosure | Unprompted disclosure |
| All qualifying disclosures in this category | Careless behaviour without significant consequences | 20% | 10% | 3% |
| First qualifying disclosure in these categories | Careless behaviour with significant consequences | 40% | 20% | 5% |
| | Deliberate behaviour | 100% | 50% | 10% |
| Second qualifying disclosure in these categories | Careless behaviour with significant consequences | 40% | 30% | 20% |
| | Deliberate behaviour | 100% | 75% | 55% |
| Third or subsequent qualifying disclosure in these categories | Careless behaviour with significant consequences | 40% | 40% | 40% |
| | Deliberate behaviour | 100% | 100% | 100% |
| No qualifying disclosure | Category of behaviour | No co-operation | Co-operation only | |
| All defaults where there is no qualifying disclosure | Careless behaviour without significant consequences | 20% | 15% | |
| | Careless behaviour with significant consequences | 40% | 30% | |
| | Deliberate behaviour | 100% | 75% | |

Note: This table refers to defaults that occurred on or after 24 December 2008 (Finance No. 2 Act 2008), where the taxpayer makes a qualifying disclosure and also to defaults where no qualifying disclosure is made. The tax geared penalty is a percentage of the underpaid tax. The penalty table for defaults that occurred before the 24 December 2008 is included in Revenue's Code of Practice for Audit and Other Compliance Interventions which is available on Revenue's website.