



TAX ABUSE AND INSOLVENCY

Issued 19 June 2018

ICAEW welcomes the opportunity to comment on *Tax abuse and insolvency: A Discussion Document* published by HM Revenue & Customs on 11 April 2018.

This response of 19 June 2018 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

This response also reflects consultation with ICAEW's Insolvency Committee which is a technical committee made up of Insolvency Practitioners working in large, medium and small practices. The Committee represents the views of ICAEW insolvency licence holders.

ICAEW connects over 150,000 chartered accountants worldwide, providing this community of professionals with the power to build and sustain strong economies. This response has been prepared in consultation with ICAEW's Corporate Finance Faculty and its Finance and Management Faculty.

© ICAEW 2018

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

For more information, please contact: representations@icaew.com

MAJOR POINTS

1. The HMRC document makes clear that it is concerned with a 'minority' (or a 'tiny minority in paragraph 2.2) who abuse the system, with the 'vast majority of insolvencies' not being of concern. It would be helpful if HMRC could provide more data/evidence as to the scale of the perceived problems upon which policy decisions are being proposed. It is essential that any measures are properly targeted. While we appreciate that the consultation document recognises this problem, it needs to be acknowledged and remembered that these proposals are potentially penal in nature and as such should be applied proportionately and in a targeted manner.
2. The document sets out three situations where it is believed that the existing insolvency rules are being abused. The paper sets out three broad areas of concern (with examples) and our comments on them are set out below.
3. Tax avoidance. We note that in HMRC's latest tax gap figures, the gap attributed to avoidance is £1.7bn which is only 5% of the total tax gap. We would have thought that only a small element of this gap is being extracted in the manner envisaged in this document. However, we would be happy to explore with HMRC the extent of this particular problem area and what could be done to reduce it.
4. Tax evasion. We would have thought that HMRC already has extensive powers under existing criminal powers to pursue such activity. Unless robust action is taken to deal with such miscreants, we suspect that adding further rules will merely provide further opportunities for them to be exploited. As we said in our recent response on the profit fragmentation consultation "adding additional legislation would make little difference to the people operating in that manner as they are already outside the rules and more robust action should be taken to deal with the offenders."
5. Repeated non-payment/Phoenixism. Again, we would have thought that the deliberate intention not to pay tax liabilities would also amount to tax evasion and again those perpetrating such activity should face similarly robust action.
6. The paper does not adequately identify behaviours for which there is already a remedy in law, and those which are not currently unlawful. Neither does it identify when directors (or the controlling mind) potentially have personal liability for behaviours of the company. In general, where the behaviour involves dishonesty/deliberate intent to avoid tax that is lawfully payable, we believe that there will be remedies already available to address the problems highlighted. We agree that the costs of enforcement in any given case may appear disproportionate, but that is a matter for decision by HMRC or other authorities and is not something that a consultation of this nature can address.
7. It is unclear whether 'phoenixism' is the most substantial concern addressed in the paper, but the tax lost as a result does seem to be the most straightforward to tackle. It is clear from other consultations (see for example our comments further below) that to promote an entrepreneurial society Government policy is that businesses should have the right to fail without undue stigma. We assume, therefore, that the possibility that a business might fail and be resurrected numerous times is not, in itself, something that HMRC questions.
8. As such, we do not believe that it would be appropriate to have a limit on number of failures permitted. Any limit would necessarily be arbitrary and there would need to be carve outs to cater for specific cases (eg where failures relate to several companies in a group).
9. However, we believe that those involved in multiple failures could and should receive far greater scrutiny by relevant authorities and at a much earlier stage, especially where there is clear evidence of previous such behaviours. For example, HMRC might decline to provide new VAT numbers to companies where there is a previous record of failure and unpaid tax.

HMRC could also make use of its existing power to demand security. Companies House could exercise tighter controls on incorporation by checking for previous failures and referring to HMRC in case of suspicion.

10. HMRC (or another government department) may wish to consider funding Insolvency Practitioners to bring action against directors when it is perceived to be in the public interest and there are insufficient resources available from the debtor's estate for the IP otherwise to bring an action. IPs do have a number of routes available to them under the Insolvency Act and are willing to use them but should not be expected to do so at their own expense. The Insolvency Service could also pursue more cases against directors where their conduct warrants this – not all cases of significant misconduct reported to it by IPs are currently pursued.
11. The paper refers to companies in financial difficulty preferring to pay suppliers in priority to taxes due. In some cases, the payments might constitute an unlawful preference and be open to challenge after insolvency, although cost issues would arise as noted above. A company that is seeking to trade for a period to turn itself around might naturally look to pay the most pressing creditors first, but that by itself would not be necessarily 'abusive'.
12. Before the Enterprise Act 2002, HMRC was a preferential creditor, but a policy decision was taken to remove this priority and that policy has continued to the current day. This is not to say that abuses/illegal acts should not be tackled, it goes without saying that they should be addressed, but it serves as a reminder that HMRC is now simply an unsecured creditor and, like other unsecured creditors, runs the risk of losing out when insolvency occurs. It should not be put in a priority position through indirect means as this would distort the intended equal treatment of creditors envisaged in the 2002 Act. This would be a particular concern in relation to the proposal for directors to have joint and several liability for tax debts (although that proposal raises many other concerns too, not least that it would undermine principles of limited liability that have promoted enterprise in the UK). That said, in practice, HMRC is often the largest creditor and could use the influence this gives it in insolvency proceedings more than it currently does.
13. We would also note that the Government is consulting on whether SME suppliers should have further protections, but any further protection would be expected to come at the expense of other creditors, including HMRC.
14. We would also note that the set-up and running costs of UK companies are now extremely low and the auditing and filing requirements for smaller companies are also much less onerous than they were in the past. In addition, it is possible to set up a company using the Companies House portal with no money laundering or due diligence procedures needed. While we understand that this may help to encourage business, a balance needs to be struck between making it easy to set up and run a business and making it too easy for those rules to be exploited by the unscrupulous.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree that HMRC should be tackling this behaviour? Are there any other forms of abuse of insolvency in relation to tax that ought to be tackled?

15. In principle ICAEW supports reasonable measures to tackle tax evasion and avoidance. We agree that HMRC should be tackling the types of abusive behaviours identified in the document but, as noted earlier, we think that HMRC may already have sufficient tools to do so without the need for these further powers, particularly given that the behaviours of the directors/controlling mind is clearly likely to have been undertaken knowingly or recklessly.
16. We would also be concerned as to whether the problems highlighted are best dealt with by changes to the tax rules, or whether changes might be required to other areas of laws, for example company/insolvency law, or whether a combination of both of them might be required.

Q2: To what extent do you consider that one of the above approaches could provide a helpful model for tackling the abuses outlined in this document?

17. We can well understand the attractiveness to HMRC of the transfer of liability and/or joint and several liability tools to tackle the types of example of abuse highlighted, but these are potentially draconian provisions and should really only be made available as a last resort and only in the most egregious of cases. It would be helpful to know how often HMRC invoke such provisions that are already on the statute book and how successful they are in bringing in the money that should have been due.
18. We would also be concerned that any rules must ensure that HMRC only pursue actual debts. It is unfortunate but all too commonplace for companies in difficulty to prioritise cash collection and revenue growth/cost cutting over the administration of the company, and thereby fail to file tax returns. In such circumstances HMRC may raise estimated assessments showing a tax liability, even where an objective review of the recent company performance often indicates an expectation of significant losses. Once the tax geared penalties and interest are added to this figure it can often become substantial. While we appreciate the intention of HMRC, in raising estimated returns, is to strongly encourage filing of returns to displace these assessments, should the company collapse with these 'tax liabilities' outstanding then clearly they should not be treated in the proposed fashion. Similar problems can arise in PAYE cases.
19. In appropriate cases there could be scope for operating a 'warning system' with such measures, so that those potentially caught undertaking such activity will face stricter rules and be exposed to potential recovery action for any future transgressions.
20. However, we reiterate the comments made above that such provisions have to be carefully targeted and only bite in the sorts of example highlighted in the paper. Sufficient safeguards should be built in to ensure that they cannot be used in cases where there the types of features highlighted were not present.

Q3. What do you think might be the key issues with applying one of these approaches to tackle the abuses outlined in this document?

21. The key issue is to ensure that any measures are properly targeted. Any solutions must be able to distinguish between the users of contrived tax schemes/evaders, and cases where businesses get into difficulties and which have simply run up a tax debt (real or otherwise). In such cases tax debts should be treated in the same way as other debts for the reasons highlighted above.

Q4: What views do you have for alternative approaches that could be adopted to tackle the forms of tax abuse outlined in this document?

22. 'Naming and shaming' has been used in other areas of the tax system in recent years and might be one possible approach that could be adopted here, but on the other hand naming such individuals may not worry the very sort of people who engage in this type of activity. It would be helpful to see if there is any evidence available that naming and shaming has had the right deterrent effect on changing behaviours before extending it to those at whom this consultation is aimed.

Q5: What safeguards should apply to ensure taxpayers' rights are protected?

23. The consultation states that rights will be protected for those in genuine difficulty (para 1.7) and that any proposal should be properly focused on those at the root of the problem (para 3.7) – with which we agree – but there is no detail about how this would be achieved. We accept that this is a first stage consultation, gathering ideas, but at the next stage HMRC must give more detail as that will be critical to the success of any proposals.
24. The measures proposed in para 3.5 would be targeted at 'the persons responsible'. This term will need very precise definition to avoid targeting the wrong people. For example, where the person responsible is not a director or shareholder of the company but what HMRC refers to as a 'controlling mind', but the directors might also be considered prima facie responsible, in view of the obligations of their role. However, there might be extenuating circumstances where a director should not be held liable, for example, someone who was coerced by the 'controlling mind' into acting as a director.
25. The definitions which ensure that only the wrongdoers are caught by new powers should be set out in legislation. We would not want to see a broad definition in legislation which is to be interpreted in HMRC guidance.
26. Paragraph 3.7 notes that 'most powers' exercised by HMRC have a right of appeal. There should be a proper right of appeal to the Tribunal and the Tribunal should have full powers to look at all the facts and circumstances surrounding a case. Further, the Tribunal should have full power to substitute any decision that HMRC may have made, including the level of any financial amounts demanded etc (for why this is important see for example para 18 above).
27. Paragraph 2.14 refers to the impact on workers where a company does not pay over PAYE or NIC and is then liquidated. This is a serious concern and arises, for example, where umbrella companies supplying workers are misused and serially liquidated. Consideration of safeguards should include how these workers might be protected. For example, if and when funds are collected through the use of any proposed new powers, they should be allocated in priority against arrears of NIC in relation to the employees concerned.

Q6: Do you consider that the above parameters for scoping the measure are appropriate?

28. See general comments made above. It is important to ensure that any debt arose as a result of tax avoidance is clearly limited to that activity, for example by linking it to the GAAR or DOTAS provisions.

Q7: Are there any other safeguards you think should be considered to ensure that genuine insolvencies are not impacted by any proposal to tackle these abuses?

29. We would be happy to explore this further with HMRC.