



HM Revenue
& Customs

Tax abuse and insolvency: A discussion document

Summary of Responses
7 November 2018

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1. Introduction

Background

- 1.1 On 11 April 2018 the government published a discussion document *Tax Abuse and Insolvency*. The discussion document asked for views on how to tackle the minority of taxpayers who exploit insolvency in trying to avoid or evade their tax liabilities.
- 1.2 The document invited comments and suggestions on dealing with those who engage in tax avoidance or evasion and side-step HMRC's efforts to recover the underpaid tax through insolvency. It also considered how to tackle corporates that repeatedly become insolvent, leaving outstanding liabilities to HMRC.
- 1.3 Comments were invited on two potential approaches to this problem:
 - Transferring liability from corporates to directors and other officers in certain circumstances; and
 - Joint and several liability for those linked to the avoidance or evasion.
- 1.4 HMRC is grateful to those stakeholders who participated in this consultation process. We received 28 responses, including written responses and those given in meetings. A breakdown of the representative capacities in which respondents made comments is as follows:
 - 11 representative bodies;
 - 13 professional advisors;
 - 4 individuals.

A list of the respondents, excluding individuals, is found at Appendix A.

2. Responses: Tax Abuse and Insolvency

How tax and insolvency regimes are misused

- 2.1 The government takes seriously the issue of corporates avoiding the liabilities they accrue from tax avoidance, tax evasion and repeated non-payment of tax. Throughout this document, we use “repeated non-payment” to refer to the practice of running up tax liabilities in a limited liability entity, then avoiding paying them by making the company insolvent – and setting up a new company to carry out the same practice again. This is sometimes known as “phoenixing” or “phoenixism”.
- 2.2 The discussion document detailed how these liabilities arise and the issues facing HMRC in trying to recover amounts in cases where these forms of non-compliance occur. It outlined some of the powers available to HMRC and other bodies and highlighted some of the challenges HMRC faces when using these powers.
- 2.3 The government is clear that the majority of insolvencies arise as a consequence of genuine financial difficulties and are unconnected with tax avoidance, evasion and repeated non-payment of tax. These insolvencies are not the focus of this measure.

Question 1. 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?

- 2.4 There was a general agreement from the majority of respondents that HMRC should counter those who run up tax debts through avoidance, evasion or repeated non-payment and side-step their payment requirements through insolvency.
- 2.5 A few respondents stated they were unclear as to the scale of the problem and were of the view that powers already available to HMRC or others should be used more extensively. Two respondents stated that the measure should not apply to cases of repeated non-payment and one that it should only apply in cases of evasion.

Comments included:

“Where deliberate abuse of the insolvency regime can be identified, then we agree HMRC should tackle it. We would however urge HMRC to make full use of existing powers to collect unpaid tax liabilities and impose security deposits before introducing further legislation.”

“Care should be taken to ensure that the principles of insolvency as a collective remedy are also respected.”

Government response

- 2.5 The government is grateful for the views expressed and recognises that the majority of companies become insolvent for legitimate reasons, but it should not be possible for companies to misuse the rules in an attempt to retain the fruits of their non-compliant behaviour. The government is therefore committed to tackling the minority that seek to misuse insolvency to avoid meeting their tax liabilities arising from avoidance and evasion.
- 2.6 As recognised in the discussion document, powers already exist to tackle aspects of this problem. However, as many of the responses acknowledge, these are often disparate in nature and focussed on particular, narrower, issues.
- 2.7 The government believes that this measure will allow greater fairness in the tax system by providing a coherent response to tackling the behaviour of those who abuse the insolvency rules. It will not undermine other creditors’ rights to payment of their liabilities.

Tackling the abuse

- 2.8 The discussion document asked for comments on two possible approaches to dealing with this issue: transferring liabilities, and joint and several liability.
- 2.9 There are already some circumstances where HMRC can transfer liability from the company to a director or other officer, but HMRC’s powers in this area can usually only be exercised in very narrow circumstances, and only in respect of certain taxes.
- 2.10 Similarly, there are already some circumstances where directors and other company officers are, or can be made to be, held jointly and severally liable for the company’s debts to HMRC; and again, they apply only in very specific circumstances which differ across taxes.

Question 2. 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?

Question 3. What do you think might be the key issues with applying one of these approaches to tackle the abuses outlined in this document?

Question 4. What views do you have for alternative approaches that could be adopted to tackle the forms of tax abuse outlined in this document?

- 2.11 There was no clear preference for one proposed model over the other, though in general most felt that joint and several liability would offer both flexibility and clarity to the taxpayer.
- 2.12 One respondent commented that joint and several liability would be preferable as the company would still have a liability, rather than have it removed in full and placed upon the transferees.
- 2.13 A small number of responses expressed concern that joint and several liability might compromise limited liability in a disproportionate way unless the measure was closely focussed on avoidance and evasion, potentially stifling enterprise. Some respondents questioned the effectiveness of this measure in respect of phoenixism and considered that measures around extending the existing security deposit legislation may be a better way of tackling this.
- 2.14 A quarter of respondents were concerned that the measures would give HMRC preferential status in prioritising all government debts ahead of other creditors.
- 2.15 There were few suggestions made for other models to adopt. One respondent suggested that it should be a criminal offence chargeable on the director or other officer to fail to make payments to Crown bodies. Another proposed the introduction of director security bonds to provide protection for creditors against director's wrong doings.
- 2.16 Others pointed out that HMRC should make greater use of existing powers, but it was generally accepted that this should be alongside rather than instead of any further powers arising from these discussions.
- 2.17 A number of respondents suggested that any measure to tackle abuse of the insolvency process should also be extended to apply to company dissolution and/or strike off.

Comments included:

“Existing powers to recover tax lost to phoenixism are scattered throughout the tax code and are not always easy to locate.”

“Any negative impact on the UK’s supportive and fair insolvency regime or corporate governance environment could be seriously unhelpful in terms of deterring or even preventing business rescue”

“We believe there should be increased HMRC focus on the use of solvent liquidations (MVLs) and striking off procedures which can often be used by directors/shareholders to remain ‘under the radar’.”

Government response

- 2.18 The government is grateful for all responses received. The government believes that extending joint and several liability to directors, company officers and other relevant related parties offers the greater flexibility to appropriately target the measure and would act as a stronger deterrent to those tempted to dissipate the fruits of their non-compliance.
- 2.19 The government considers that joint and several liability provides the best available option as it will enable HMRC to take targeted and proportionate action prior to insolvency proceedings, when it is clear that revenue is at risk. Making relevant persons jointly and several liable for corporate liabilities at this stage will discourage them from causing their company from becoming insolvent unnecessarily.
- 2.20 The extension of joint and several liability to directors, company officers and other relevant related parties will only be available in cases of tax avoidance, evasion and repeated non-payment of tax to ensure that this measure does not stifle enterprise in genuine commercial businesses.
- 2.21 HMRC's measure to extend security deposits to Corporation Tax and Construction Industry Scheme (CIS) deductions supplements the aims of this measure by targeting this behaviour up-stream and ensuring that non-compliant taxpayers are encouraged to change their behaviour going forward.
- 2.22 The government does not believe criminal action would be appropriate in these circumstances. In the context of these proposals, director bonds would not offer the flexibility of the proposed joint and several liability, and are likely to impose a higher administrative burden.

Safeguards

Question 5. What safeguards should apply to ensure taxpayers' rights are protected?

- 2.23 All of those who responded to this question were of the view that there need to be clear safeguards set out in legislation and most felt that there should be a right of appeal to the Tribunal against HMRC action.
- 2.24 Many respondents required a more precise definition of the term "the persons responsible" contained within the consultation document. Two respondents also recommended that any exemptions should be stipulated in primary legislation as an important safeguard to protect those Insolvency Practitioners, directors and company officers who were not responsible for the behaviour in point.
- 2.25 Some respondents proposed that a safeguard for creditors be written into the legislation such that HMRC is unable to put itself ahead of unsecured creditors.

Comments included:

“Any new tax legislation introduced must have...safeguards built in to ensure taxpayers' rights are protected, and the primary safeguard will be clearly defining the target for this measure”

“It is imperative that built-in procedural and legislative safeguards remain available, in particular, a right of appeal to the Tax Tribunal. This must be a process which is fair and accessible to all.”

Government response

2.26 The government fully agrees that strong safeguards are an essential element of this measure. The government proposes an appeal right to prevent disproportionate outcomes, together with clear definitions, discussed below, to determine when and to whom the measure will apply, to ensure it is appropriately targeted.

Scope

Question 6. Do you consider that the above parameters for scoping the measure are appropriate?

Question 7. Are there any other safeguards you think should be considered to ensure that genuine insolvencies are not impacted by any proposals to tackle these abuses?

2.27 Several respondents considered a clear definition of the behaviours which would bring an individual into (and out of) scope would be more effective than listing the forms of non-compliance. One respondent took the opposite view that is essential that the measure scopes out the forms of non-compliance which would attract personal liability.

2.28 Some respondents considered that the definition of avoidance should be linked to the General Anti-Abuse Rule (GAAR) or Disclosure of Tax Avoidance Schemes (DOTAS) provisions.

2.29 No further safeguards were proposed.

Comments included:

“We would...suggest that the extent to which a person has benefited or could benefit from the "non-compliance" should be a factor which would determine the extent to which an individual might be impacted by the measure.”

“Motives and advance knowledge are notoriously difficult to target, evidence and test. The concepts superficially appeal...however, in practice, motive tests

create uncertainty and cost for compliant taxpayers and HMRC as they are difficult to evidence, defend or challenge.”

Government response

- 2.30 The government agrees that it is essential that the forms of non-compliance that are within scope of the measure are clearly defined to ensure that the measure is appropriately targeted at the prescribed behaviour and genuine insolvencies are not impacted.
- 2.31 The measure will only apply where HMRC considers that avoidance or evasion has taken place, or where they have evidence of phoenixism. HMRC will only be able to collect a charge when there is an established liability and it is clear that the liability has arisen through avoidance, evasion or phoenixism. Proper targeting of the measure is essential to ensure that genuine insolvencies are not caught, with the added safeguard of an appeal right to prevent disproportionate outcomes.
- 2.32 The government recognises the particular concerns around targeting tax avoidance and intends for the GAAR and DOTAS provisions to be included as definitions of tax avoidance for the purposes of this measure.
- 2.33 Additionally, the government intends to ensure that this measure would also address those who, as a result of seeking to enable or facilitate others to avoid or evade tax, have incurred certain HMRC penalties and then move into insolvency as a way of avoiding paying those penalties.
- 2.34 Those who facilitate tax avoidance and evasion often do this through companies. When HMRC applies a penalty to that behaviour, it is not right that they can then side-step this sanction by liquidating the company on which the penalty is raised. The government therefore proposes that penalties raised on facilitators of avoidance under DOTAS, Disclosure of Avoidance Schemes VAT and Other Indirect Taxes (DASVOIT), Promoters of Tax Avoidance Schemes (POTAS) and Avoidance Enablers, and penalties on facilitators of evasion should be brought within scope.

Annexe A: List of stakeholders consulted

Ashurst
Association of Accounting Technicians
Association of Taxation Technicians
Centrica
Chartered Institute of Taxation
City of London Law Society
Deloitte
Federation of Small Businesses
Grant Thornton
Griffins
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Insolvency Lawyers' Association
Johnston Carmichael
Kingston Smith
KPMG
Law Society of Scotland
Low Incomes Tax Reform Group
Mazars
McTear Williams and Wood
PricewaterhouseCoopers
R3
RSM UK
UK Finance

