Tax Abuse and Insolvency: HMRC Discussion Document and Extension of the existing security deposit legislation to include CT and CIS deductions

Management of taxes

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CIOT, LITRG and ATT all responded to the consultation on proposals to extend the existing security deposit legislation and the discussion document exploring ways to tackle abuse of the insolvency regime to avoid or evade tax liabilities, including through the use of phoenixism, noting the interconnection between the two proposals

In March, HMRC published a consultation document on proposals to extend the existing security deposit legislation to corporation tax and construction industry scheme deductions. This was followed in April by the publication of an HMRC discussion document exploring ways to tackle abuse of the insolvency regime to avoid or evade tax liabilities, including through the use of phoenixism. As there is an element of interconnection between the two topics, they are both dealt with in this article.

Tax abuse and insolvency

The CIOT, LITRG and ATT each responded to HMRC's discussion document.

CIOT and LITRG met with HMRC in June to discuss the proposals and then both submitted written responses. Overall CIOT's view is that HMRC's approach looks sensible in cases where the insolvency regime is being intentionally abused resulting in tax liabilities that are properly due deliberately not being paid, and existing powers available to HMRC are insufficient to tackle the problem. The key challenge will be in defining the mischief to be addressed, so that legislation is sufficiently well targeted to ensure companies that are not engaging in such behaviour are not adversely affected. We also urge HMRC to make full use of existing powers to collect unpaid tax liabilities and impose security deposits before introducing further legislation.

In their submission, LITRG highlighted that the insolvency regime seems to be behind the somewhat cavalier behaviour they have seen from certain employment intermediaries such as some umbrella companies. However, LITRG recommended that prior to making any new, wide-reaching rules to secure funds lost through insolvency, HMRC should make more and better use of their existing powers, such as the discrete debt transfer provisions that exist in relation to incorrectly assessed travel and subsistence relief. This should include publicising when such powers have been used in order that there is a deterrent effect, as prevention is surely better than cure.

LITRG went on to say that this approach should be given a chance to work. If, after a time, the evidence suggests that new rules are still required, HMRC need to think holistically about making them. Issues around the use of the insolvency regime are not restricted to tax abuses – some employers that LITRG are aware of use it to avoid paying awards/settlements in relation to employment tribunal matters. Unless this type of abuse is also dealt with, it is likely that there will be an increased use of models of engagement under which there is a rich windfall to be had, based on the denial of employment law rights.

Instead of submitting a written response, ATT met representatives of HMRC in May to consider the discussion paper and identify key issues. ATT highlighted the need to distinguish between the various types of abuse identified by HMRC (tax avoidance, evasion and phoenixing) and to target the counter-measures accordingly. By way of simple example, ATT suggested there is limited merit in attempting to attach an unpaid corporate tax debt to an individual company officer or other person whose abusive behaviour had caused the non-payment if they have no means with which to meet any transferred liability.

ATT emphasised the importance of differentiating between situations where there was abusive intention (however defined) and those of 'genuine commercial difficulties' and drew particular attention to cases where such genuine commercial difficulties prompted a behavioural response which morphed into what might be seen as abusive. As an example, the directors of what had been a fully compliant business but which had hit trading difficulties might be advised on how they could salvage the trade through phoenixing. In that situation, there would have been no intention to default on tax liabilities when the problems arose – so seeking to impose personal liability in that situation would appear inappropriately draconian.

ATT also noted the sometimes inconsistent approach by HMRC to requests for time to pay arrangements which meant that companies that were in genuine (as distinct from intended) financial difficulties were often professionally advised not to contact HMRC because of the inherent unpredictability of HMRC's response.

The full CIOT response can be found on the CIOT website.

The full LITRG response can be found on the LITRG website.

Extension of the existing security deposit legislation to include corporation tax and construction industry scheme deductions

The CIOT and LITRG met with HMRC in June to discuss the proposals. The CIOT then submitted a written response on the proposal to add CIS to the security deposit regimes.

In principle, the CIOT supports steps to protect the revenue where tax is at risk because businesses default on their CIS and CT obligations. This already applies for PAYE, VAT and other indirect taxes. We acknowledge that there are businesses/directors that are living on the edge and who are trying to duck and dive around their tax/VAT obligations and knowingly use the tax/VAT monies to run the business. We agree that protection of the current and future revenue in those cases is a real concern and HMRC should legitimately take a tough approach.

There are, however, also cases where viable businesses get into difficulties and where HMRC should help them trade out of their difficulties rather than require a security deposit. In these cases, we think HMRC must not take a blinkered approach to protecting the revenue as this will simply result in the loss of future tax revenue by killing the business. We suggest that to safeguard businesses that need help rather than applying 'the stick' the legislation should clearly state that use of the security deposit regime must only be deployed where it is 'appropriate and proportionate' to do so.

The CIOT therefore recommends that prior to extending the security deposit regime to CIS and CT, HMRC commissions independent research into its current approach to imposing security deposits and the effect demands for a deposit have had on struggling businesses. HMRC should take on board lessons to be learned from past use of security deposits and modify their approach accordingly.

While LITRG did not make a written response, they highlighted the problem of false self-employment in the construction industry to the officials in the meeting. LITRG explained that this could be relevant where, for example, a CIS deposit is taken but the debt is strictly, one of PAYE. In such cases, HMRC could hopefully take

a pragmatic approach and repurpose the CIS security deposit accordingly.

The full CIOT response can be read on the CIOT website. The draft legislation to extend the regime to both CIS and CT was published on 6 July 2018.