



Law Society
of Scotland

Consultation Response

Tax Abuse and Insolvency: A Discussion Document

June 2018



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

We welcome the opportunity to consider and respond to HM Revenue and Customs' consultation: *Tax Abuse and Insolvency: A Discussion Document*¹. We have the following comments to put forward for consideration.

Consultation 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?

We consider that HMRC should be tackling serial and deliberate abuse of the tax system carried out by the misuse of insolvency of companies or similar structures. The extent of this problem is not known to us and we are of the view that action should only be taken on an evidence base demonstrating the need for measures to be taken by HMRC. We appreciate that deliberate abuse by the misuse of insolvency procedures can result in manipulation of the economic market and impact upon other businesses which are acting legitimately.

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?

We consider that both approaches suggested have the potential to contribute to tackling the abuses described. We note that at present, there are variable powers in relation to both transfer of liability and joint and several liability across all taxes. Business' tax liabilities are likely to consist of a variety of types of tax,

¹ <https://www.gov.uk/government/consultations/tax-abuse-and-insolvency>

for example Corporation Tax, Excise duties, VAT, Capital Gains Tax, Business Rates, and PAYE and NICs for employees. We therefore consider that in respect of both these methods, there would be merit in having a consistent approach available to HMRC across all taxes. We are of the view that these methods alone will not be 'catch all' measures in respect of abuse of insolvency practices.

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

Perhaps the most significant issue with application of these approaches will be ensuring that the proposed measures are suitably defined so as not to impact upon those individuals and businesses that face genuine commercial difficulty. In addition, it appears that the individuals for whom this consultation is targeted are those who are involved at the time that tax avoidance and/or evasion is being undertaken, and/or at the time that the business entered insolvency. We do not expect that those who are appointed subsequently or Insolvency Practitioners who are appointed to wind up a business are intended to fall into the target group of these measures. Care should therefore be taken to ensure sufficiently 'tight' definitions are used to target the actions appropriately.

In relation to the transfer of liability and joint and several liability proposals, we do not consider that these can be seen as a 'catch all' measure due to the potential for further evasion of the liability by the individual. There is the potential for individuals to continue to evade tax responsibility, for example, by transferring assets into the name of another individual such as a family member.

We appreciate that in practical terms, there is often benefit in early intervention as opposed to punitive measures. In relation to the extension of security deposit legislation, we suggest that regular review is carried out to ensure that legislation does not create a barrier to the market by stifling the start-up of legitimate new businesses. We do not give an opinion on the use of Advance Payment Notices (APN) but would encourage HMRC to continue to explore affordable payment arrangements with businesses if necessary.

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

There are a number of other approaches which could be taken to tackle such abuse. We consider that caution requires to be taken to ensure an appropriate balance is struck between promoting legal compliance and tackling misuse of the insolvency procedures, while ensuring that methods of doing so are not too draconian to impact adversely upon businesses and stifle the economic market.

We consider that greater use could be made of the digital tax regime to facilitate 'joined-up' thinking and increase traceability of individuals. We have identified two potential features of this. Firstly, markers could be used for individuals such as company directors to allow for monitoring across all tax platforms via their NI number. This may assist in identification of businesses which are using 'phoenixism' strategies by

placing the company into insolvency and a 'new' company with the same personnel buying assets and continuing to trade.

In addition, the digital platform could be used to assist the identification of connected persons and businesses. This may assist in tackling scenarios where businesses incur liabilities, dissolve a company, and transfer assets into another company under the directorship of a connected individual, such as a business partner or family member. At present, there may be difficulties in pursuing liabilities in such circumstances if the individual cannot be traced and/or liability cannot be transferred. The 'clean skin' principle presently makes it difficult for the new business director to be pursued however we consider that means to identify connected persons may facilitate the tackling of such abuse. There would however require to be suitable safeguards in place in any such system to ensure that individuals who genuinely acquire a business without knowledge of the evasive or non-compliant behaviour are not prejudiced.

There may be scope for the introduction of tax clearance certificates for acquiring businesses, such as is required for judicial factors to demonstrate that all taxes have been paid. Acquiring businesses could be required either to assume liabilities from the selling company or to acquire a clearance certificate confirming that all tax liabilities of the selling company had been met. We do consider that any such scheme would require careful consideration to ensure that innovation is not stifled. In our view, this would provide protection to those acquiring businesses legitimately as such enquiries are likely to be carried out as part of the usual due diligence process but also afford some greater protection to HMRC in relation to tax liabilities. If such a scheme were to be introduced, we suggest that regular evaluation would be required to monitor any adverse impact on the market. We do appreciate that such a scheme is not faultless due to the potential for companies to repeatedly run up further tax liabilities and carry out 'phoenixism' behaviour with the result that tax liability is in reality not met.

We note that the Insolvency Service can currently seek disqualification of a director due to misconduct. This power however may have limited impact on 'phoenixism' behaviour due to the potential for a disqualified director to remain involved in the background running of a new business, with another, possibly connected, person as director. We consider that there is scope for Insolvency Practitioners (IP) to make a report to HMRC when, during the course of their work in winding up a business, it appears that there is a 'substantial preference' for payments to directors and creditors other than HMRC. This could bring such matters to the attention of HMRC to facilitate further enquiries. In relevant circumstances, there may also be merit in requiring IPs to report businesses and/or individuals to professional bodies.

We note the potential serious impact on employees of misuse of insolvency in this manner. PAYE and NICs may have been deducted from earnings but not paid to HMRC. This could impact on an employee's personal record. We understand that in practice in such circumstances, employees are frequently credited with the relevant contributions. In this regard, we consider that there may be merit in greater public education and awareness-raising around tax responsibilities and the ownership of individuals' tax liabilities. We consider that if HMRC establish such cases of non-payment of PAYE and NICs by employers, employees should be warned of the potential impact on their personal record of this.

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

As referred to above, suitably precise definitions are required to ensure that only those carrying out serial and deliberate abuse are caught by the provisions. This will ensure that those who face genuine commercial difficulties which result in insolvency proceedings are not adversely affected. In addition, care should be taken around the application of rules to individuals - for example, there is the potential for such measures to impact upon non-controlling directors who have not been in a position to have caused or prevented the actions resulting in tax liabilities arising.

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.

In relation to joint and several liability, there would be merit in safeguards associated with such a measure to protect innocent parties – for example, a threshold test requiring a pattern of knowledgeable and persistent behaviour or excessive liabilities.

There does not always appear to be a consistent approach taken by HMRC in relation to enforcing compliance. Greater consistency would be welcome to ensure just outcomes for all. As referred to above, we suggest that there is regular monitoring and evaluation of any measures introduced to tackle abuse to ensure that there is no adverse impact upon the market. We consider that any benefits to HMRC of increased tax revenues are reinvested into the system for improvements.

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

We do not seek to make substantive comment on the parameters proposed. We do note that there is fine line to be drawn between acceptable tax avoidance such as legal tax planning and mitigation, and tax avoidance falling foul of GAAR and tax evasion. We would stress the importance of suitable definitions being used.

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?

See our answer to question 5.

For further information, please contact:

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