



HM Revenue
& Customs

Tax Abuse and Insolvency: A Discussion Document

Discussion Document

Publication date: 11 April 2018

Closing date for comments: 20 June 2018

Subject of this discussion:	<p>This document seeks views on how to tackle the small minority of taxpayers who abuse the insolvency regime in trying to avoid or evade their tax liabilities through the use of companies or similar structures, including through the use of phoenixism.</p> <p>This document is only targeted at companies and similar structures who are non-compliant in this way. It does not target companies of any particular size, and companies who are compliant will not be impacted by this measure.</p>
Scope of this discussion:	We would welcome views on how best to tackle the abuse outlined by this document, whether this is through legislation, operational measures or other action.
Who should read this:	We would like to hear from businesses, individuals, insolvency specialists, tax advisers, professional bodies and other interested parties.
Duration:	The consultation will run for 10 weeks from 11 April to 20 June 2018.
Lead official:	Ellen Roberts, Counter Avoidance Directorate, HMRC
How to respond or enquire about this discussion:	<p>Written responses should be submitted by 20 June 2018 by email:</p> <p>ca.consultation@hmrc.gsi.gov.uk</p>
Additional ways to be involved:	HMRC welcomes meetings with interested parties to discuss these proposals.
After the discussion:	A response document will be published later this year, and any legislative changes will be taken forward as part of a future Finance Bill.
Getting to this stage:	<p>At Autumn Budget 2017 and Spring Statement 2018 the government announced that it would be exploring ways to tackle those who deliberately abuse the insolvency regime in trying to avoid or evade their tax liabilities, including through the use of phoenixism.</p> <p>Additionally, the government announced at Autumn Budget 2017 that it will extend existing security deposit legislation to include corporation tax and Construction Industry Scheme deductions. A separate consultation document to consider the most effective means of introducing this change was published on 13 March 2018. While complementary, this change does not address the full range of challenges outlined in this document.</p>
Previous engagement:	Responding to changing behaviours, the government has introduced wide-ranging measures to bear down on tax evasion and tax avoidance. At Autumn Budget 2017 the government published <i>Tackling tax avoidance, evasion and non-compliance</i> to outline the further action that will be taken to address these issues.

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1. Introduction

- 1.1 The overwhelming majority of taxpayers meet their tax obligations, which pay for the UK's vital public services. A minority deliberately flout the rules, or try to bend them in a way never intended by Parliament, seeking to pay less tax than they owe.
- 1.2 This government has been resolute in its fight against tax evasion and tax avoidance. Since 2010 HMRC has secured over £175 billion in additional compliance revenue as a result of its actions to tackle tax evasion, tax avoidance and non-compliance – helping the UK to achieve one of the lowest tax gaps in the world.
- 1.3 However, there is a minority who artificially and unfairly seek to reduce their tax bill through the misuse of insolvency of companies or similar structures¹: they combine non-compliance with their tax obligations with an abuse of the insolvency regime's aims.
- 1.4 These people use tax avoidance, tax evasion, or repeated non-payment– and when they are discovered by HMRC, they seek to misuse insolvency in an attempt to side-step their tax liabilities. 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”. These types of behaviour are explained further in Chapter 2 of this document.
- 1.5 If successful, these people gain an unfair advantage on two fronts: both by avoiding paying the tax they owe and failing in their duties to the company's creditors. They also make it more difficult for legitimate businesses to compete, meaning that those who abuse their duties as company owners in this way may force out those businesses that act responsibly and contribute to society and the economy by paying the taxes due. Throughout this document, references to “insolvent” companies are not limited to mean companies that have commenced formal insolvency proceedings, but also refer to instances where the company is functionally insolvent, e.g. they have ceased trading and have tax liabilities outstanding.
- 1.6 The focus of this document is those taxpayers who, in respect of corporate insolvencies:
 - try to exploit the insolvency procedures to avoid or evade taxes and/or payment of taxes and duties;

¹ For ease of reference throughout this document we talk about the “company” to refer to all forms of limited liability entities, including limited liability partnerships.

- attempt to protect or hide the gains of tax avoidance or tax evasion; and/or
- repeatedly accumulate tax debts without payment by running them through a succession of corporate vehicles (also known as “phoenixism”).

1.7 The vast majority of insolvencies are not artificial in this way – they relate to genuine commercial difficulties and these are not the focus of this discussion document. This document does not target companies of any particular size. Companies who are in genuine difficulty and have not engaged in tax avoidance, tax evasion or repeated non-payment of taxes should be absolutely clear that their rights will continue to be protected.

1.8 The people who drive such actions deliberately misuse insolvency for their own gain. This behaviour deprives the public purse of monies needed to fund vital public services. It also seeks to circumvent the insolvency regime’s safeguards that aim to protect creditors’ rights.

1.9 This document seeks views on how the government can make the tax system fairer for everyone: by ensuring that companies who use tax avoidance, tax evasion and repeated non-payment cannot also misuse the insolvency regime to sidestep their tax liabilities.

1.10 This document aims to begin a conversation about the nature of this abusive behaviour, and how it could be tackled. It is structured as follows:-

- What the problem is
- Existing powers
- Possible approaches
- Safeguards
- Scope

2. How tax and insolvency regimes are misused

Challenges faced by HMRC

- 2.1 HMRC undertakes a range of compliance activities, from full tax enquiries to a variety of targeted interventions aimed at a particular activity or aspect of a taxpayer's affairs. When HMRC finds underpaid, undeclared or understated tax, they issue assessments to the taxpayers concerned, or amend the incorrect return or claim. They may also charge penalties and interest if appropriate. These actions formally establish a tax liability which the taxpayer is required to pay, subject to any appeals they might wish to make when payment of the tax may be postponed in some circumstances. Once the liability is established, most companies in this position pay what is due. Additionally, HMRC may issue an Accelerated Payment Notice (APN) to people we believe have used tax avoidance schemes. APNs seek payment of disputed tax in advance of a case being settled. Recipients must pay the tax owed within 90 days - they pay now, dispute later. In all cases, if companies face problems paying the liability, HMRC will work with the company, to explore affordable payment arrangements, including offering more time to pay if appropriate.
- 2.2 However, a tiny minority seek to escape their liability even at this stage by misusing insolvency to retain their avoidance or evasion gains, or to benefit from repeated non-payment.
- 2.3 The insolvency regime exists to support restructuring and rescue for businesses in financial distress. Where this is not possible, it provides an orderly and fair winding-up of the business' affairs and distribution of available assets to creditors. The winding-up of a business' affairs will often involve HMRC as most companies will have some tax liability at the point they become insolvent.
- 2.4 In the event that a company commences formal insolvency proceedings during HMRC's compliance activity, the company's assets will be divided between creditors – including HMRC. This approach ensures that company owners have a limited liability in the event that their company can no longer continue.
- 2.5 However, HMRC is aware that some people are misusing insolvency to circumvent their tax responsibilities. These people own or manage companies and then cause or allow their companies to engage in tax avoidance, tax evasion, or repeated non-payment of taxes due. They might do this in a number of ways, for instance:
 - the director/shareholder/controlling mind uses tax avoidance or tax evasion to extract value from a company;

- the company accumulates tax debts, but pays its suppliers to ensure their support so that the director/shareholder/controlling mind can continue the company's business through a successor if necessary;

Then:

- the company becomes insolvent (whether formally or functionally) holding no assets with which to meet its liabilities (including tax liabilities), often because those assets have been dissipated in anticipation of the winding up;
- the director/shareholder/controlling mind may continue acting in another guise (e.g. same trade, using the same customers/suppliers etc.).

2.6 One of the challenges to HMRC in tackling this behaviour relates to how debts are established under the tax framework. Most creditors establish that a debt is owed to them when they invoice the company for the provision of goods or services. By contrast, there is usually a time difference between when the tax liability arises and when a debt is established by HMRC. This is due to one or more of the following:

- the company submits a tax return at the end of their accounting period, resulting in a tax liability arising. Depending on the tax, the return might not need to be submitted until a point some months after the action to incur the liability has taken place;
- HMRC enquires into the tax affairs of a company, establishing that additional tax (and potentially interest and penalties) is due; and/or
- the company appeals against an assessment to tax made by HMRC, meaning that the assessment to tax is postponed as a debt until the point that the appeal is concluded.

2.7 All of the above examples are necessary mechanisms of ensuring that the tax system works in an effective and proportionate manner. However, it does mean that there is considerable scope for a company to go into insolvency after the tax liability has arisen – but before the debt is enforceable. This can make it difficult to recover the full amount of tax liability from an insolvent company.

Insolvency Practitioners

2.8 Insolvency Practitioners are qualified persons who are licensed and authorised to act as office holders in relation to insolvency proceedings. Only insolvency practitioners can legally act as office holders in insolvency proceedings: as trustees in bankruptcy, as liquidators, administrators and administrative receivers of companies, and as supervisors of Individual Voluntary Arrangements and Company Voluntary Arrangements.

2.9 An officeholder does have a number of legal actions available to them to clawback assets from the director/shareholder and/or to impose personal liability on them for the company's debts pursuant to the Insolvency Act 1986. However, pursuit of these proceedings is:

- expensive;
- reliant on the provision of information to the officeholder and/or HMRC;
- subject to litigation risk; and
- dependant on the officeholders' appetite for such litigation.

As a result, even if proceedings are instigated they often end up in a "commercial" or discounted settlement being reached.

2.10 All of the above means that a director/shareholder/controlling mind who chooses to misuse insolvency may receive a significant discount on the tax liability or pay nothing at all - enabling them to retain the fruits of tax avoidance, tax evasion and/or the commercial advantage of repeated non-payment. The examples below illustrate these behaviours in turn: tax avoidance, tax evasion and "phoenixism".

Example – tax avoidance

The director of John Ltd, Mr S, uses a tax avoidance scheme to extract money from the business without paying tax and to increase business profits available for extraction. The avoidance scheme was used in 2008, 2009 and 2010 and HMRC begin a compliance intervention into the company's returns. In 2011 the business of the company is sold to a third party at full value and the profits from the sale are extracted for the benefit of Mr S via another tax avoidance scheme. No funds are left in the company to pay the potential tax liabilities if the avoidance schemes fail. In 2012 HMRC raises assessments for the understated tax. The company appeals against the assessments and payment of the tax is postponed pending the outcome of the appeal. HMRC wins on appeal. The company is unable to pay the tax due and Mr S places John Ltd into voluntary liquidation in January 2015.

Mr S delivers up minimal books and records to the liquidator so that he only becomes aware of the avoidance debt when informed by HMRC. The liquidator sets about pursuing the recovery actions.

Mr S offers £500,000 to settle the claims against him of £1.2million. The liquidator accepts the settlement and, as a non-preferential creditor, after costs HMRC receive £200,000 in relation to a tax debt of £1million.

Example – tax evasion

A Ltd ran a business with very few employees on the payroll. On investigation, HMRC found that A Ltd had been deliberately hiding the employment status of their workers

from HMRC by falsifying their company records, and that a lot of self-employed workers providing services to A Ltd should actually have been treated as A Ltd's employees. Over £6m of PAYE and NICs had been evaded as a result of this. Following HMRC's investigation, A Ltd agreed to put all its workers onto RTI, and returns were submitted to HMRC. However, no payments were made to HMRC, and in the meantime A Ltd's director purchased another company – B Ltd – and put A Ltd into administration. All of A Ltd's employees were transferred across to B Ltd. The director of A Ltd was made to resign from B Ltd in order to allow B Ltd to continue as a business and meet other regulatory requirements – however he continues to run the business behind the scenes. Since then, B Ltd has paid all of its PAYE, NICs and VAT liabilities, totalling £5m. However the tax of £6m relating to A Ltd remains unpaid.

Repeated non-payment / Phoenixism

- 2.11 Phoenixing, or phoenixism, are terms used to describe the practice of carrying on the same business or trade successively through a series of limited liability entities (usually companies) where each becomes insolvent in turn. Each time this happens, the insolvent entity's business, but not its debts, is transferred to a new 'phoenix' entity.
- 2.12 From HMRC's perspective, phoenixism involves the running up of tax liabilities in a limited liability entity, then escaping payment by making the entity insolvent. The new entity will typically be run by the same person(s) who ran the insolvent entity. The assets will often be acquired by the new entity - sometimes at less than their full value, to increase the benefit to the person(s) driving these actions still further. It creates unfair commercial advantages, undercutting competition in the marketplace.

Example – Phoenixism

Janet Ltd is a close company that has recently been formed. Over a period of 12 months, Janet Ltd accumulates large debts, including tax debts, stalls creditors for as long as possible, and eventually goes into liquidation. Shortly afterwards, Janet Co. Ltd purchases the productive assets and takes over the operations of Janet Ltd. Janet Co. Ltd operates out of the same premises as Janet Ltd, with the same suppliers, employees and customers.

Example – Employment Intermediary

DEF Ltd is an employment business which employs and provides circa 500 workers per week to businesses requiring temporary or specialist labour. The business has little in the way of tangible assets and operates from rented accommodation. DEF Ltd's sole director previously ran another Company, ABC Ltd, which traded from the same premises, was in the same line of business and which went into liquidation owing £500K to HMRC in unpaid PAYE, NICs and VAT, with no other creditors. DEF Ltd paid all its PAYE, NICs & VAT liabilities for the first 6 months of trading but debts are now starting to accrue. The director of DEF Ltd has recently registered another Company, HJK Ltd, which is currently registered as dormant.

- 2.13 Phoenixism is unfair to all creditors, who may not be paid even if the insolvent entity's business continues. However, its impact is especially pronounced from HMRC's perspective. In many instances, creditors other than HMRC will be paid by the new company in order to secure ongoing supplies and ensure that the business can continue in the new company. In the event that creditors remain unpaid, they can choose not to conduct business with the new company to ensure that they do not encounter non-payment again. By contrast, HMRC cannot avoid phoenix companies' repeated non-payment of liabilities: it cannot choose who to do business with, and it cannot refuse credit.
- 2.14 There can also be a serious impact on the workers, when their employer goes into liquidation. If PAYE and NICs have been deducted from their earnings, and not paid over to HMRC by the company, this could affect the employees' personal record of NIC contributions impacting on certain entitlements.
- 2.15 The Insolvency Service can seek disqualification of a director based on their misconduct, which may include instances where a director has caused or allowed the company to trade to the detriment of a creditor, including HMRC. However, this does not of itself address the tax lost to the Exchequer.

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?

3. Tackling the abuse

Existing Powers

- 3.1 To tackle this type of behaviour, there are provisions within Insolvency legislation that allows assets to be clawed back in certain circumstances, for the benefit of creditors as a whole.
- 3.2 HMRC also has some powers to address attempts to abuse the insolvency rules to avoid paying tax. However, these powers apply unevenly across the taxes, meaning that tax-motivated insolvency cannot be uniformly addressed.
- 3.3 For example, if an insolvent company is found to have deliberately underpaid CT and Excise duties (and such actions are attributable to company officers), HMRC can transfer liability of the penalties due in respect of the Excise duties to the insolvent company's directors – but not the Corporation Tax. The government would like to consider whether there are more efficient ways to tackle non-compliance with the tax rules where insolvency is exploited.
- 3.4 Additionally, the government announced at Autumn Budget 2017 that it will extend existing security deposit legislation to include corporation tax and Construction Industry Scheme deductions. There is evidence that securities can be effective in driving compliance and protecting revenue when used in a targeted way and this measure addresses gaps in the existing coverage. A separate consultation document was published on 13 March 2018 to consider the most effective means of introducing the extension of the security deposit legislation. While complementary, the extension of securities legislation would not address the full range of challenges outlined above.

Possible approaches

- 3.5 A number of methods of tackling this type of behaviour already exist in discrete areas of the tax code. One way of addressing the abuses outlined above more efficiently would be to adopt these principles more widely. For example:
 - **Transfer of liability:** As outlined above, HMRC can already transfer liability of certain tax debts to company directors and officers in particular circumstances. This power could be extended to transfer liability to tax debts to the persons responsible for the avoidance, evasion or repeated non-payment of taxes when there is a risk the funds will be lost in insolvency.
 - **Joint and several liability:** This principle would enable HMRC to hold the persons responsible for the avoidance, evasion or repeated non-payment of taxes jointly and severally liable for tax debts in the event that the company could not meet the tax debts.

- 3.6 Both of the above principles could be extended to apply across all taxes in prescribed circumstances, which would avoid this behaviour being tackled unevenly on a tax-by-tax basis. As well as views on these suggestions, we would welcome suggestions on other ways to tackle this form of abuse – whether these are legislative or non-legislative.

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?

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

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

Safeguards

- 3.7 The government recognises that any new powers should have relevant safeguards, to ensure they are used appropriately and that taxpayers and other creditors' rights are protected. As part of this, any proposal should be properly focussed on those at the root of the problem. Beyond this, most powers exercised by HMRC have built-in procedural and/or legislative safeguards, such as a right of appeal to the Tax Tribunal. The government would want to tailor any safeguards to the particular proposal, but would welcome views on what safeguards might be appropriate in the context of tackling such abuses.

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

Scope

- 3.8 If a new approach were adopted to tackle these abuses, it will be vital to ensure that its scope is clearly defined. As outlined above, the government is committed to ensuring that companies undergoing genuine difficulties that are unrelated to tax avoidance, evasion and repeated non-payment of tax are not impacted. Any potential powers in this area could be targeted by defining:

- the forms of non-compliance that would trigger such a measure (i.e. tax avoidance, evasion and repeated non-payment);
- the behaviour of the person(s) who would be impacted by the measure; and/or
- the behaviour of the person(s) who would **not** be impacted by the measure.

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

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?

4. Summary of 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?

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?

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

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

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

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

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?

5. Process and Next Steps

This discussion is being conducted in line with the Tax Consultation Framework.

There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This discussion is taking place during stage 1 of the process. The purpose of the discussion is to seek views on the policy design and any suitable possible alternatives, before consulting later on a specific proposal for reform.

How to respond

A summary of the questions in this consultation is included at chapter 4.

Responses should be sent by 20 June 2018 by e-mail to ca.consultation@hmrc.gsi.gov.uk or by post to:

Ellen Roberts
3/41, 100 Parliament Street
London
SW1A 2BQ

Telephone enquiries to Ellen Roberts, 03000 594918 (from a text phone prefix this number with 18001)

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act, General Data Protection Regulation (GDPR) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue & Customs.

Consultation Privacy Notice

This notice sets out how we will use your personal data, and your rights. It is made under Articles 13 and/or 14 of the General Data Protection Regulation (GDPR).

Your Data

The data

We will process the following personal data: Name, email address, postal address, telephone number.

Purpose

The purpose(s) for which we are processing your personal data is:
Public consultation on: *Tax Abuse and Insolvency*.

Legal basis of processing

The legal basis for processing your personal data is that the process is necessary for the exercise of a function of a Government Department.

Recipients

Your personal data will be shared by us with HM Treasury.

Retention

Your personal data will be kept by us for six years and will then be deleted.

Your Rights

- You have the right to request information about how your personal data are processed, and to request a copy of that personal data.
- You have the right to request that any inaccuracies in your personal data are rectified without delay.
- You have the right to request that any incomplete personal data are completed, including by means of a supplementary statement.
- You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- You have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted.

Complaints

If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

Contact Details

The data controller for your personal data is HM Revenue & Customs. The contact details for the data controller are:

HMRC
100 Parliament Street
Westminster
London
SW1A 2BQ

The contact details for the data controller's Data Protection Officer (DPO) are:

DPOHM Revenue & Customs
9th Floor, 10 South Colonnade
Canary Wharf
London E14 4PU

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.