

HM Revenue & Customs (HMRC) – a discussion document
Tax abuse and insolvency
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

- 1.1 We welcome the opportunity to provide brief comments on insolvency and tax abuse. We would also refer you to the comments made in our meeting of 7 June 2018.
- 1.2 In principle, we agree there is a problem with the insolvency regime being used to avoid or evade tax liabilities, including through the use of phoenixism. Indeed, the insolvency regime seems to be behind the somewhat cavalier behaviour we have seen from certain employment intermediaries such as some umbrella companies – providing them with ‘an easy way out’, if and when HMRC catch up with them.
- 1.3 From our work in this area, there seems to be a pattern in place whereby certain businesses roll out non-compliant/high return PAYE arrangements (under which a rich windfall is garnered), wait for HMRC to catch up with them (if at all), then fold – thus completely bypassing the tax arising from their deliberate failure to apply the rules.
- 1.4 This said, we recommend that prior to making any new, wide-reaching rules to secure funds lost through insolvency (which will only add complexity and which risk collateral damage), HMRC should make more and better use of their existing powers. 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.
- 1.5 We would have thought that a combination of the discrete debt transfer provisions that exist in certain areas of the tax code, powers under the new Criminal Finance Act and the

ability to take security deposits - if used/publicised properly - would be very effective in driving up standards of behaviour.

- 1.6 This will not only help stop businesses defaulting on their tax obligations, but will help protect workers and compliant business alike, and this must surely also be at the heart of HMRC's work.
- 1.7 HMRC should be aware that issues around the use of the insolvency regime to avoid costs and obligations are not restricted to tax – some employers that we are aware of use it to avoid paying awards/settlements in relation to employment tribunal matters. If action against abuses is restricted to the tax system, it may well be the case that problems start springing up elsewhere.

2 About Us

- 2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HMRC and other Government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

- 3.1 As a group of tax specialists with an interest in and insight into the tax and related welfare issues of agency workers who find themselves caught up in certain 'umbrella' arrangements, we welcome the opportunity to provide brief comments on insolvency and tax abuse.
- 3.2 In 2014, we issued our report 'Travel expenses for the low-paid – time for a rethink?'¹ in which we looked in detail at agency workers and their use of a particular 'umbrella' scheme (pay-day-by-pay-day (PDPD)) to obtain tax relief for their travel costs. Typically, this results in some small tax/National Insurance (NIC) savings for the workers, considerably outweighed

¹ <https://www.litrg.org.uk/latest-news/reports/141117-travel-expenses-low-paid—time-rethink>

by cost advantages accruing to the employers (particularly when one considers the fees levied).

- 3.3 HMRC called the model ‘non-compliant’, yet it flourished. One of the main reasons for this was that the businesses involved had very little fear of action being taken against them. The fact that the insolvency regime was there to ‘protect’ businesses from any action HMRC *did* take, further fuelled the fire.
- 3.4 For example, in our report we highlighted that, in early 2013, HMRC might have been intending to pursue a PDPD case against a company called Legitas. After initially making a statement that the company was changing its payroll practices,¹ Legitas and other group members went into Creditors Voluntary Liquidation. HMRC reportedly claimed some £58million was owed to them,² however no official comment was ever made from HMRC on the case.
- 3.5 We assume that this is the type of ‘mischief’ that the proposed extension of powers is intended to counter. However, the type and nature of the schemes in common use have changed as the market has moved on, and PDPD schemes are no longer so widespread. In some respects then, creating new rules to counter PDPD abuse is too little too late.
- 3.6 While there are ongoing, different, problems with umbrella companies, in 2014 HMRC introduced rules to transfer company PAYE debts to directors³. In 2016, HMRC introduced similar powers around travel and subsistence debt (which we look at in section 4.2). These two provisions could be most useful to HMRC when employment intermediary debt is at risk of being lost to insolvency and we think they need to be given time to work before further new powers are considered.
- 3.7 While we appreciate that such debt transfer provisions apply unevenly across the system, meaning that tax-motivated insolvency cannot be uniformly addressed, we understand from HMRC that the abuses identified in the discussion document are not actually ubiquitous, and are mainly confined to a couple of discrete areas/sectors (of which employment intermediaries are one).
- 3.8 This first step should therefore be to review the most problematic areas and the availability and use of existing tools available within them. If, after a suitable amount of time, there is evidence that they are not having the intended impact, then it would be reasonable for HMRC to consider making new powers.

¹ As reported by ‘Recruiter’ on 18 April 2013 – see <http://www.recruiter.co.uk/news/2013/04/legitas-switches-temps-to-payee-afterconcerns/>

² See report at <http://www.heraldscotland.com/news/home-news/edinburgh-firms-enter-liquidation-after-58m-tax-claim.21393708>

³ <https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2046>

- 3.9 As we have some hesitation in commenting on the scope/safeguards, etc. of any news rules, we have only answered questions 1, 2, 3, and 4.

4 Questions

4.1 **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?**

- 4.1.1 We agree that HMRC should be tackling this behaviour. It is not right that businesses can duck their obligations by using the insolvency regime and HMRC should legitimately be taking a tough approach.
- 4.1.2 In terms of employment intermediaries in particular, having the insolvency regime as the ultimate backstop seems to encourage the use of non-compliant/high return models. The effect is even more pronounced in this sector, as the barriers for operators to enter into the ‘umbrella’ industry are low – it is relatively easy to set up an umbrella structure without a significant capital outlay and they have few other creditors or suppliers to worry about if/when they fold.
- 4.1.3 Over time, and as a consequence, bad practices have largely driven out good and we have seen more umbrella company models based on increasingly degraded terms, which can have devastating consequences for workers caught up in them and also compliant businesses that are being undercut.
- 4.1.4 Loss of revenue is therefore not the only problem arising out of this situation and in this respect, prevention is surely better than cure.
- 4.1.5 As such, whatever action is taken, we would like to stress the importance of HMRC *using* any powers that they have – *and then publicising that they have used them* – to send out a strong message and to help act as a disincentive to businesses considering exploiting the system.
- 4.1.6 We suggest HMRC publicise their actions in news items on GOV.UK and in ‘Spotlights’ for example.¹ While we appreciate that HMRC’s standard approach is that it does not comment on the affairs of individual taxpayers due to the duty of confidentiality, our view is that not divulging any details whatsoever is counter productive and so HMRC should consider if any new statutory powers are need to facilitate them to do so in certain circumstances.²
- 4.1.7 HMRC should see if they can learn anything from The Pensions Regulator (TPR) who are widely regarded as successful and effective at enforcing the auto enrolment

¹ <https://www.gov.uk/government/collections/tax-avoidance-schemes-currently-in-the-spotlight>

² s18 Revenue and Customs Act 2005, provides that HMRC may not disclose any information held by HMRC except if that disclosure is “*made for the purposes of a function*” of HMRC.

programme. In particular, their enforcement and compliance bulletins¹ make for interesting reading as they set out cases and the powers TPR have used in the quarter, relating to automatic enrolment and associated employer duties.

- 4.1.8 Where the TPR consider a case is sufficiently important they may publish specific details.² While they use these powers in a measured way, they say having the ability to publish detailed information about their enforcement activity plays a vital part in securing the important outcomes of transparency, education and guidance and deterrence.³
- 4.1.9 We suggest that what the TPR are doing, as well as other comparators with an enforcement function (for example, the Gangmasters Licencing and Abuse Authority⁴), would be worth investigating further as part of HMRC's work in this area.

- 4.2 ***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?

- 4.2.1 The approaches outlined in the discussion document of debt transfer and joint and several liability could prove helpful for tackling abuses. However, in many of the areas where tax abuses are widespread, HMRC probably already have such powers written into the law.

¹ <http://www.thepensionsregulator.gov.uk/docs/compliance-and-enforcement-quarterly-bulletin-january-to-march-2018.pdf>

² <http://www.thepensionsregulator.gov.uk/doc-library/regulatory-intervention-reports.aspx>

³ The TPR say:

Transparency: We recognise that it is in the public interest to ensure that everyone has a greater understanding of how we exercise our statutory functions. An important aim of publication is to increase understanding of how and when we have used our powers.

Education and guidance: To provide guidance to improve practices, behaviours and compliance with legal obligations which otherwise might lead to intervention; and to encourage higher standards by sharing good practice.

Deterrence: To deter unlawful or improper practices or behaviours, to increase awareness of such practices or behaviours and to inform others who may be adversely affected by such practices or behaviour

⁴ The GLAA also write up case studies for press releases: <http://www.gla.gov.uk/whats-new/latest-press-releases/290118-cornish-gangmaster-revoked-after-string-of-issues-uncovered/>

- 4.2.2 For example, under the provisions associated with the April 2016 travel and subsistence expenses changes for umbrella companies,¹ incorrectly assessed 'supervision, direction and control' debt can be transferred to the directors of the umbrella company and also to other parties in instances where it can be shown that the umbrella company has been misled by that party into believing travel and subsistence relief was allowable when in fact it was not.²
- 4.2.3 While we appreciate that there will be instances where HMRC cannot rely on these powers, e.g. because there is a foreign director who is outside the reach of UK's jurisdiction, it is not clear to us that any new overarching rules allowing debt transfer to directors will work here either.
- 4.2.4 In terms of alternative approaches, and in line with the premise that prevention is better than cure, we would have thought that the Criminal Finance Act 2017³ could be used by HMRC to help secure compliance in many of the most problematic areas, such as those involving employment intermediaries. For example, under the Act, penalties can arise for agencies where a worker evades tax and the commissioning of that offence is facilitated by a third party (e.g. an umbrella company) who is 'associated' with the agency. Agencies are required (if they want to have a defence) to have reasonable procedures in place to prevent the facilitation of tax evasion.
- 4.2.5 It also seems to us that HMRC could make more use of their ability to require a PAYE security deposit in the form of cash, or a guarantee in the form of a performance bond issued by a financial institution.
- 4.2.6 If HMRC decide that new rules really are required, we think that abuses are best addressed by the introduction of further precisely targeted measures rather than through wide-reaching changes, which could impact on insolvencies that are not tax driven as well as those that are (not to mention create a substantial amount of unproductive work for HMRC in trying to establish the difference).
- 4.2.7 HMRC should think holistically when making targeted new rules. Issues around the use of the insolvency regime are not restricted to tax abuses – some employers that we are aware of use it to avoid paying awards/settlements in relation to employment tribunal matters.
- 4.2.8 At the bottom end of the labour market, there is a vicious model of engagement of agency workers that exploits the fault line between tax law and employment law, the elective deductions model.

¹ Namely ITEPA s 688B and PAYE Regulations (SI 2003/2682) Chapter 3B

² Further explained here: <https://www.gov.uk/government/publications/employment-intermediaries-travel-expenseguidance/travel-and-subsistence-expenses-for-workers-engaged-through-employmentintermediaries-from-6-april-2016#ESM5660>

³ <https://www.gov.uk/government/news/stop-facilitating-tax-evasion-or-face-criminal-prosecution-hmrc-tells-corporations>

- 4.2.9 Under this model, the individual is treated as an employee for tax purposes where PAYE is operated (this means that as far as HMRC are concerned, everything appears to be in order), but treated as self-employed for all other purposes. This means that they may not be paid the minimum wage, be given paid annual leave, etc. Such treatment will be generating cost savings for the businesses but benefiting the workers in no way at all.
- 4.2.10 Unless the ability for employers to use the insolvency regime to avoid paying awards/settlements arising from things like denial of holiday pay is also dealt with, it is likely that we will just see the increased use of such models.

LITRG
20 June 2018