SQUIRE PATTON BOGGS

Tax and Insolvency

The New UK Laws Making Directors Jointly and Several Liability for the Company's Tax Liabilities

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While much of the focus of the insolvency and restructuring world has (rightly and understandably) been on the fundamental changes introduced under the Corporate Insolvency and Governance Act 2020, it is worth remembering that there have been major tax changes, too.

The Finance Act 2020 changed the tax on insolvency rules in two respects. The first, amending the Insolvency Act 1986 (and its equivalents in Scotland and Northern Ireland) to restore HM Revenue & Customs (HMRC) as a secondary preferential creditor in insolvency proceedings with effect from 1 December 2020, has received plenty of coverage. However, despite having the potential to have a much greater impact, the second change, the introduction of new rules making directors, shadow directors and certain others jointly and severally liable for a company's tax liabilities in insolvency situations, has taken effect relatively quietly.

The new regime is lengthy and complex. It is intentionally broadly drafted so as to act as a deterrent. As a result, the regime has potential application in a wide, much wider than might first appear, range of circumstances and the ability to create serious personal financial burdens. This note outlines the key provisions.

Does [Not Do] Exactly What It Says on the Tin

Cracking Down on Avoidance

It is worth noting the policy intention for the new rules is to combat abusive tax avoidance (and evasion) arrangements that seek to use the insolvency laws to circumvent a tax liability.

Although not limited in scope to address a single concern, the rules arise as a response to the government's dissatisfaction with the adequacy of its powers to tackle "phoenixism" – i.e. the practice of carrying on the same business through a series of companies where each company becomes insolvent but transfers its business (less liabilities, including taxes due) to a successor company. The abusive nature of such an arrangement is especially evident where value has been extracted from the company through a tax avoidance scheme. HMRC has been steadily building its powers of investigation and armoury of counteraction over the past few years; the joint and several liability rules are the latest iteration of a long-term trend.

Since 22 July 2020, in certain circumstances involving insolvency or a potential insolvency, any director or shadow director of, or any other individual otherwise connected to, a company can be made jointly and severally liable for amounts that are payable to HMRC by the company. The regime is also extended to members and shadow members of limited liability partnerships (LLPs).

HMRC has to issue a joint liability notice (JLN) to trigger the rules. Subject to numerous conditions, HMRC can issue a JLN in three broad cases:

- Tax avoidance and tax evasion
- Repeated insolvency and non-payment cases
- Cases involving penalty for facilitating avoidance or evasion

Tax Avoidance Arrangements and Tax-evasive Conduct

For cases involving tax avoidance and tax evasion, five conditions need to apply:

- The company has engaged in tax avoidance arrangements or tax-evasive conduct
- The company has entered into an insolvency procedure or there is a serious risk of it doing so
- The individual issued with the notice was either:
  - Responsible for (or helped plan or implement) the avoidance or evasion
  - Received a benefit knowing (or could reasonably be expected to have known) it arose as a result of the avoidance or evasion
- A tax liability is likely to be due as a result of the avoidance or evasion
- There is a serious possibility some or all of that liability will not be paid

An individual receiving a JLN relating to tax avoidance and tax evasion will be jointly and severally liable with the company for the company's liabilities to HMRC arising from the tax avoidance or evasion.

Phoenixism

For cases involving repeated insolvency (i.e. phoenixism), four conditions need to apply:

- During the five years prior to the issue of the notice, the individual had a "relevant connection" with – i.e. was a director or shadow director of, or was a participator in – at least two "old" companies that:
  - Have become subject to an insolvency procedure
  - Had an outstanding tax liability at that time
- Another company carries on a trade similar to that of at least two of the old companies
- During the five years prior to the issue of the notice, the individual had a "relevant connection" with – i.e. was a director or shadow director of, or was a participator in – or was involved (whether directly or indirectly) in the management of the new company
- At least one of the old companies still has a tax liability outstanding in an amount exceeding £10,000 and representing more than 50% of the total amount due to its unsecured creditors

An individual receiving a JLN relating to phoenixism will be jointly and severally liable (with the new company) for any amounts due to HMRC from the new company when the notice is issued, or which arise during a period of five years from the issue of the notice, and will be jointly and severally liable (with any relevant old company) for any amounts still due to HMRC from that old company.

Facilitation of Avoidance or Evasion

For cases involving a penalty for facilitating avoidance or evasion, four conditions need to apply:

- The company has been charged a penalty (or proceedings have been commenced to charge a penalty) under one of several specified sets of anti-avoidance disclosure, promoter and enabler rules
- The company has entered into an insolvency procedure or there is a serious risk of it doing so
- The individual issued with the notice was a director or shadow director of, or was a participator in, the company when the act or omission occurred that gave rise to the penalty (or penalty proceedings)
- There is a serious possibility some or all of that liability will not be paid

An individual receiving a JLN relating to penalties for facilitation will be jointly and severally liable with the company for the relevant penalty.

Reviews and Appeals

Individuals receiving a JLN have the right to request HMRC to review its decision to issue one and the right to appeal against it to the courts. Where a company is appealing against a tax liability that is the subject of a JLN, the individual is entitled to join the company as a party in the appeal (and can continue it if the company withdraws). Where the company does not appeal against a tax liability that is the subject of a JLN, the individual is entitled to appeal in their own name.

Doing What It Says on the Tin?

The common theme in each of the three cases is that HMRC must establish the liability has arisen through tax avoidance, evasion or phoenixism. To help "target" the rules, the new regime references existing anti-avoidance rules (including, but not limited to, the UK's General Anti-Abuse Rule (GAAR) and Disclosure of Tax Avoidance Schemes (DOTAS)) in defining its scope.

However, given the broad nature of the multiple regimes referenced, the overall effect is to create a very wide set of circumstances that can trigger the issue of a JLN. Add that to the relatively subjective extension of the rules to situations involving potential insolvencies, and the inclusion of participators, too, and the net result is a regime that circumvents the "limited liability" status of companies and creates latent secondary tax liabilities for what could be a very large group of individuals (including company directors, shadow directors and its investors and shareholders, irrespective of involvement or actual knowledge of the actions of the company) across a lengthy five-year period. Furthermore, despite the after-the-event safeguards afforded by the right to review and appeal, there is little to protect genuine restructurings and insolvency situations that arise solely as a result of a commercial downturn for (however inadvertently) being caught and challenged.

With businesses struggling in the wake of the COVID-19 pandemic, the rules will demand careful and considered attention.

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