Insolvency and tax avoidance: a rude awakening

Is insolvency a Director's useful response to the consequence of tax avoidance schemes? Could the taxpayer be storing up further trouble and potentially even a bigger bill, asks Elliot Green

When the debts of a company become unmanageable, liquidation might not be far away. But is insolvency the answer for a Director with that tax avoidance problem?

Insolvency can sprout anytime and as a result, the relationship between tax avoidance and insolvency can be seen all stages in the tax enquiry and investigation process.

A company that has gone into liquidation will rarely trade and it is axiomatic it will eventually flatline. Nevertheless, the company is kept on life support by its liquidator, guided by the Insolvency Act 1986. That means that HMRC will still have a role to play in its future.

A considerable number of insolvent liquidations have arisen in recent years with tax liabilities arising from such tax avoidance schemes as Employee Benefit Trusts (EBTs) or Employer Financed Retirement Benefit Schemes(EFRBS). HMRC typically plays an active role in such liquidations in the furtherance of their investigations into these schemes.

It is not hard to see why these schemes have been targeted by HMRC enquiries. An idiosyncrasy of many is that they may appear if nothing else somewhat artificial, sending money around in a circle. Furthermore, often the loans that all too often feature, are not repaid. In the case of Ecology Support Services Ltd v Hellard [2017] EWHC 160 (Ch) the liquidator appears to have likened circular schemes and the consequential movement of money to being like that of a "spinning top".

Arguably, such schemes appear to suffer the risk of impermissibility because save for tax avoidance they potentially have no other desiderata.

The insolvent company's tax enquiry

Insolvency can change the dynamics of a tax enquiry and any consequential trip to the Tax Tribunal.

It is unlikely to improve the company's prospects of going before a Tribunal. In many cases there will be no money left behind for a liquidator to pursue any appeal, assuming it is considered to have merit.

Insolvency will however change the personality with control over the conduct of the enquiry. The taxpayer will now be controlled by the Insolvency Practitioner who acts instead of the Directors. In a liquidation only the liquidator has standing to prosecute a tax appeal (see GP Aviation Group International Limited [2014] 1 BCLC 474). The Tax Tribunal has exclusive jurisdiction to resolve tax disputes between the taxpayer company and HMRC. Usually, the Insolvency and Companies Court will not intervene.

On insolvency the tax enquiry rumbles on, potentially with renewed vigour. This is perhaps ironic given the insolvency usually will indicate that the prospect of full recovery of the tax will drop like a stone. However, prior to liquidation HMRC's requests for information may be closely monitored and influenced by recommendations put forward by the Promoter of the Tax Avoidance Scheme. Once the company goes into liquidation, the Promoter's influence may decline. Liquidators deal with HMRC daily and typically ought to understand the duty to HMRC.

That duty can perhaps not be better articulated than how it was promulgated in Nicholson v Morris (H M Inspector of Taxes) 51 TC 95: "...it is idle for any taxpayer to say to the Revenue, 'Hidden somewhere in your vaults are the right answers: go thou and dig them out of the vaults.' That is not a duty on the Revenue. If it were, it would be a very onerous, very costly and very expensive operation, the costs of which would of course fall entirely on the taxpayers as a body. It is the duty of every individual taxpayer to make his own return and, if challenged, to support the return he has made, or, if that return cannot be supported, *to come completely clean*..."

HMRC may therefore anticipate (and receive) useful information from an Insolvency Practitioner in the furtherance of their investigations into a scheme. This may assist HMRC if it is considering launching a challenge to a particular scheme in the Tax Tribunal.

Investigations on several fronts

Once the company goes into liquidation a Director could find themselves fighting on several fronts. While Directors might feel some initial relief from releasing themselves from the company's tax enquiry at the outset of liquidation, they can still end up facing tax enquiry questions put forward instead by the liquidator.

Furthermore, to add salt to the wounds, if inadequate provision has been made for tax but the company coffers still nevertheless have been emptied by way of subsequent dividend extractions (since the opening of an enquiry but prior to liquidation), the liquidator may initiate investigations into their lawfulness. And, if HMRC considers the tax avoidance scheme particularly egregious, a Director who attempted use liquidation as an exit route might still have to grapple with a Personal Liability Notice (PLN).

The old adage that which is cheap can be expensive may still therefore be true.

Tax avoidance schemes and insolvency proceedings

The impact of tax avoidance in insolvency proceedings has not been a judicial backwater.

The credibility of using EBTs as a tax avoidance mechanism suffered a blow following the landmark decision, RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) (Appellant) v Advocate General for Scotland (Respondent) (Scotland) [2017] UKSC 45 ('the Rangers Decision'), handed down by the Supreme Court. It determined that the tax avoidance scheme used by Rangers Football Club was ineffective and that PAYE and NIC should have been deducted when payments were made into the scheme.

HMRC seems to be succeeding in the fight against tax avoidance, particularly when it appears able to show that an avoidance scheme had no purpose, other than tax avoidance. The Rangers Decision seems to have speeded up the prior glacial progression of tax avoidance cases. Indeed, now liquidators have challenged payments into such tax avoidance schemes with alacrity. Notably in the reported cases of Ball (PV Solar Solutions Ltd) v Hughes [2017] EWHC 3228 (Ch) ('PV Solar') and more recently in Re Implement Consulting Ltd [2019] EWHC 2855 (Ch) ('Implement Consulting'). In both PV Solar and Implement Consulting, the liquidators successfully challenged tax avoidance related transactions and Directors were liable to account to these insolvent companies for significant losses.

Implement Consulting was particularly conspicuous following the exegesis of Chief Insolvency and Companies Court Judge Briggs: "...the Respondents had caused the capital reserves to be swept from the balance sheet since 2009 notwithstanding the presence of a risk that sums would become due to HMRC as a direct result of the 'aggressive tax' planning undertaken by the Company; (vi) no provision had been made for a risk that was apparent even if they believed it to be remote or unlikely".

The author has investigated a number of EBTs in company liquidations with schemes ostensibly rooted in employee incentivisation. Perhaps, however, even the incurious and insouciant mind might not be so readily convinced by such a rationale, a fortiori in cases of owner managed businesses whose only beneficiaries of the EBTs were the Directors and their families.

In the author's experience it is not the subsequent inability to avoid tax that might have disincentivised some Directors from continuing to trade. Indeed, some Directors simply reverted to prior practice of declaring and paying dividends once the disguised remuneration legislation came into effect in the Finance Act 2011. However, insolvency may have culminated after issuance by HMRC of Advanced Payment Notices (APNs) with the additional interest and penalties, for which there might have been paltry provision.

While many tax avoidance schemes may appear to promote more in tax planning terms than they might sometimes deliver, a Director who does not take independent professional advice on them and carefully review their typically heavily caveated terms of engagement, may find themselves at a notable disadvantage when insolvency comes along.

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