



Johnston Carmichael LLP response to HM Revenue & Customs invitation to comment on “Tax Abuse and Insolvency: A Discussion Document”

Background

Johnston Carmichael LLP is the largest independent accountancy firm in Scotland. We have one of the most respected restructuring teams in Scotland who regularly act for HMRC and other creditors on insolvency assignments. The head of our restructuring team, Donald McNaught, is the current chair of the ICAS Insolvency Committee. ICAS are the main regulator of insolvency practitioners in Scotland.

Summary

This discussion paper addresses long standing issues within the insolvency regime and the dilemma faced in striking the balance between encouraging enterprise and preventing abuse. The potential remedies could have the effect of piercing the corporate veil which, alone, would represent a significant shift away from the existing culture.

It is our view that the insolvency regime has sufficient remedies available to deal with misconduct but, as the paper suggests, the costs and risks associated with employing those powers usually result in them not being used. Delinquent directors know this and, at the same time, the disqualification process holds little fear for certain directors who will use others as their proxy.

Response to individual questions

Q.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?

Yes. We think HMRC should be encouraged, however, to use the existing remedies to allow insolvency practitioners ("IP's") to pursue rogue directors.

We believe the paper covers the main areas where we would see insolvency being used to avoid tax.

As a firm that performs insolvency work we would wish to challenge the assertion that the liquidator settlement in one of the examples is not necessarily the best outcome. The liquidator should have weighed up the commercial reality of further recovery action against the individuals and may have concluded that they personally had insufficient assets to pay in full. This would have been no different an outcome to one where HMRC had increased powers and initiated bankruptcy proceedings. In fact, it may be enhanced if other personal creditors of the individuals are not brought into play. The example suggests HMRC wishes to then have an enhanced position over other creditors of the company, including preferential ones which represents a conflict with existing pari passu principles and insolvency

legislation. That could result in lenders, ordinary trade creditors or employees being prejudiced with far reaching consequences of reducing appetite to provide credit.

Q.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.

Clearly the prospect of personal liability will help discourage tax debts being wilfully created and then avoided via insolvency. At the same time, the unintended consequences of this could result in a severe reduction in enterprise and the prospect of 'one size fits all' approach resulting in innocent directors being punished for genuine commercial failures.

We agree that these powers could be effective in the most extreme cases or with repeat offenders. Similar to the disqualification process HMRC could be supported in their determination by separate reporting by the appointed IP. Where the IP has been appointed by the directors, HMRC could obtain reassurance from an independent appointment. That report could consider the quantum of the debt, the directors' culpability, the length of time the debt outstanding and the relative position of HMRC to other creditors. At the same time, identifying wider mitigating factors such as the sector conditions.

Q.3 What do you think might be the key issues with applying one of these approaches to tackle the abuses outlined in this document?

Piercing the corporate veil. This would be a significant step change and HMRC should be careful to avoid a situation where enterprise is stifled because the personal risk of trading is too high.

Q.4 What views do you have for alternative approaches that could be adopted to tackle the forms of tax abuse outlined in this document.

As above, we think existing remedies exist but are not utilised enough. A combination of those plus enhanced HMRC powers in the most extreme cases could provide a strong deterrent.

Q.5 What safeguards should apply to ensure taxpayers' rights are protected?

As above, we think there is a role for IP's here to support HMRC's investigations. As the paper states, IP's are qualified and regulated individuals with significant experience of these matters. We have experience of acting on HMRC's instructions where an independent IP's appointment

was sought to replace a director's choice. That was an effective way to ensure the proper independent scrutiny and the taxpayer can be reassured that their conduct is being considered by someone outwith HMRC.

Q.6 Do you consider that the above parameters for scoping the measure are appropriate?

Beyond considering the behaviours of the individuals and the form of non compliance, it is important to look at the wider context of the behaviour and mitigating factors. For example, many directors trade on with the genuine intention of trading out of their loss making position. If they are exposed to personal guarantees and suffer personal loss that would suggest insolvency was not a preferred option. These considerations are very similar to the approach that the Insolvency Service take when considering disqualification actions.

Q.7 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?

As above, we think a hybrid approach where existing tools are used with some enhanced HMRC powers would work best. Adopting some of the best practices of the disqualification process when assessing misconduct and also utilising the skills and expertise of the existing

IP community would go some way to deterring tax avoidance via insolvency without deploying much more far reaching powers which would have scope to both harm enterprise and unduly punish innocent parties.

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