

New Tax Risks for Directors: Insolvent Companies and COVID-19 Fraud

August 25, 2020

Finance Act 2020: This Time It's Personal (Liability)

The Finance Act 2020 introduces new rules which make certain individuals who have a 'relevant connection' to a company that is, or is likely to become, subject to an insolvency procedure (an "insolvent company")¹ jointly and severally liable for certain tax liabilities of the insolvent company. Under the new rules, HM Revenue and Customs (HMRC) can issue a joint and several liability notice (JSLN) to directors, shadow directors, participators (broadly, shareholders) and individuals directly or indirectly concerned, or who take part, in the management of a company (i.e., those individuals that have a 'relevant connection' to an insolvent company) in respect of certain tax liabilities of the company if it appears to HMRC that the individuals concerned have been involved in one of the following activities of the insolvent company:

1. tax-avoidance arrangements or engagement in tax-evasive conduct;
2. the repeated insolvency of companies and formation of new companies (phoenixism) together with non-payment of tax liabilities; or
3. cases involving penalties for facilitating tax avoidance or evasion.

Where a JSLN is issued by HMRC, the insolvent company and those individuals with a relevant connection are made jointly and severally liable for the company's tax liabilities and penalties arising from the above three circumstances. Where the insolvent company no longer exists, the individuals are wholly responsible for the outstanding liabilities.

Whether an individual has a 'relevant connection' varies depending on which of the above three circumstances is in point. In circumstance 1 (tax avoidance arrangements and tax evasive conduct), there has to be some actual involvement by the individual in the tax avoidance or evasion concerned, such as facilitating, implementing or benefiting from the arrangement. In circumstance 2 (phoenixism), however, an individual can have a relevant connection and so be jointly and severally liable if they have merely been a director, shadow director or participator of the old company or companies and director, shadow director, participator or involved in the management of the new company or companies in question in the previous five years. In circumstance 3 (penalties for facilitating tax avoidance or evasion), an individual has a relevant connection to the insolvent company if they were a director, shadow director or participator at the time of the facilitation.

An appeal against a JSLN can be made by the individual and HMRC can be required to undertake a review of its decision. There is also an ability for individuals to dispute HMRC's calculation of the tax liability, even where the company that holds the primary liability no longer exists.

HMRC has defended the broad new measures as seeking to '*tackle the small minority of taxpayers who artificially and unfairly seek to reduce their tax bill through the misuse of insolvency of companies*'. HMRC has confirmed it will seek to enforce the new measures by monitoring insolvency cases and through communication with taxpayers and practitioners affected by the new rules.

¹ "Insolvency procedure" means a company which is put into administration or liquidation or, a company which is likely to be put into administration or liquidation.

Clients should consult legal counsel if they intend to use the insolvency rules to restructure or reorganise their company in order to manage tax liabilities that could potentially incur.

Fraud in the Time of COVID-19

The Finance Act 2020 introduces powers for HMRC to investigate company directors, shadow directors and management who are suspected of abusing the rules of the Coronavirus Job Retention Scheme (CJRS) and to recover monies paid under the CJRS to which the employer was not entitled. The Finance Act 2020 gives HMRC powers to levy a charge for 100 percent of the amount received where a person makes an incorrect claim for CJRS. In addition, there is a minimum penalty of 30 percent of the CRJS grant improperly claimed, with a maximum penalty of 100 percent in cases where abuse was deliberate or concealed.

As of 9 August, 9.6 million jobs have been supported through the CJRS, with claims worth £34.7m billion, according to official government statistics². The UK government has been quick to respond to concerns that the CJRS scheme was susceptible to fraudulent claims and that monies paid out were not used to pay employees.

The Finance Act 2020 triggers a 90-day grace period from 22 July for employers to notify HMRC if they have received furlough payments to which they were not entitled, without incurring any penalties. Employers are encouraged to notify HMRC about any improper CJRS claims to avoid a penalty made on the basis that the wrongdoing was 'deliberate and concealed'.

On 9 July, HMRC issued a press release confirming they had made their first arrest under the new rules as part of an investigation into a suspected £495,000 CJRS fraud. Computers were seized and funds in a bank account relating to the company were frozen. Furlough fraud is a criminal offence on under the Fraud Act 2006. However, the Finance Act 2020 adds civil penalties where the CJRS payment has not been used to pay employees wages, Pay As You Earn (PAYE) income taxes, National Insurance contributions (NIC) or pension contributions.

There have been cases where furloughed workers have been asked to carry out work whilst receiving support through CJRS which has, as a result, caused workers to make anonymous reports of breaches of the CJRS to HMRC. HMRC confirmed that, as of 7 August, it had been sent 7,791 reports of potential fraud related to the CJRS and is encouraging more employees to make reports if they are concerned. Employers should bear this in mind if the employer/employee relationship has become strained in the current circumstances.

While HMRC have powers to investigate they may hand over the case to the Crown Prosecution Service which may make the final charging decisions. HMRC's announcement of their first arrest indicates how seriously HMRC are using their investigation powers to protect taxpayer's money in respect of the CJRS, which has always been intended to support businesses during the pandemic.

Directors have a statutory duty to exercise reasonable care and skill to carry out their duties in the best interest of the company and these duties may be breached if HMRC concludes that there has been a misuse of CJRS funds by the directors. Directors, therefore, should be mindful of their statutory obligations to act in the best interest of the company.

Schedule 16 to the Finance Act 2020 explains that company officers shall be held jointly and severally liable for penalties and the failure to notify HMRC. This could result in all directors, even those not directly involved in the claiming of CJRS payments, being held personally liable for repayment of the funds to HMRC.

We recommend that directors check whether any CJRS claims have been made on behalf of companies of which they are officers to ensure that any such claims were made in accordance with the rules and confirm that any payments received were applied properly.

² <https://www.gov.uk/government/collections/hmrc-coronavirus-covid-19-statistics#coronavirus-job-retention-scheme>

CONTACTS

For more information about Finance Act 2020, contact your Katten lawyer or any of the following:



Charlotte Sallabank
+44 (0) 20 7776 7630
charlotte.sallabank@katten.co.uk



Kit Fowler
+44 (0) 20 7770 5212
kit.fowler@katten.co.uk



Christopher Hitchins
+44 (0) 20 7776 7663
christopher.hitchins@katten.co.uk



Brigitte Weaver
+44 (0) 20 7770 5235
brigitte.weaver@katten.co.uk

Katten

katten.com

Paternoster House, 65 St Paul's Churchyard • London EC4M 8AB

+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

Katten Muchin Rosenman UK LLP is a Limited Liability Partnership of Solicitors and Registered Foreign Lawyers registered in England & Wales, regulated by the Law Society.

A list of the members of Katten Muchin Rosenman UK LLP is available for inspection at the registered office. We use the word "partner" to refer to a member of the LLP. Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

Katten Muchin Rosenman UK LLP of England & Wales is associated with Katten Muchin Rosenman LLP, a US Limited Liability Partnership with offices in:

CENTURY CITY | CHARLOTTE | CHICAGO | DALLAS | LOS ANGELES | NEW YORK | ORANGE COUNTY | SHANGHAI | WASHINGTON, DC

8/25/20