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THE FINANCE ACT 2020: PROVISIONS FOR JOINT AND SEVERAL TAX LIABILITY FOR DIRECTORS, MANAGERS, SHAREHOLDERS AND LENDERS

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By Oliver Walker, Natasha Ayres and Ellie Marques

The Finance Act 2020 provides that directors, managers, shareholders, lenders and others can be made jointly and severally liable for the outstanding tax debts of insolvent (or potentially insolvent) companies and limited liability partnerships (LLPs).

From 22 July, officers of HMRC may, if they consider the various conditions are met, issue a notice to directors and other relevant individuals who own shares or interests in, or who are involved in the management of, the company or LLP. Following receipt of a notice, the relevant individual is jointly and severally liable with the company (or LLP) for the outstanding tax liabilities set out in the notice and HMRC will be able to recover the relevant amount directly from the individual.

The Government has previously said that these rules should only apply to taxpayers who artificially and unfairly seek to reduce their tax bill through insolvency proceedings. However, the legislative provisions are extremely broad in their reach, and could potentially apply in a number of different scenarios.

For example, the rules have the potential to affect any individual that falls within the stated criteria (as to which see below), in some cases regardless of the individual's involvement in, or actual knowledge of, the offending activity. It seems that an individual could be a step removed from, or perhaps even unaware of, the wrongdoing and still receive a joint liability notice.

Further, it will be down to an HMRC officer to determine whether the criteria for liability are met. It may be possible for different HMRC officers to take different views, which could lead to an inconsistency in approach, although it is to be hoped that such officers will be given appropriate training to try to minimise any such inconsistencies. There is only limited scope for review or appeal.

Given their potential breadth of application, the impact of these new rules will need to be carefully considered when implementing any restructuring involving HMRC liabilities, particularly when dealing with large group structures with weak corporate governance.

The provision and the relevant liabilities

The potential liability arises under section 100 and Schedule 13 of the Finance Act 2020, and can catch tax liabilities that either:

1. relate to a period ending; or
2. arise from an event or default occurring,

on or after 22 July (s100 (2) and (3)).

Scope

The liability arises where the individual is given a notice in:

1. tax avoidance and tax evasion cases (Sch 13, para 2 (1));
2. repeated insolvency and non-payment cases (Sch 13, para 3 (1)); or
3. cases involving penalty for facilitating avoidance or evasion (Sch 13, para 5 (1)).

Those at risk will be directors, shadow directors, those involved in management and individuals who are shareholders or loan creditors (referred to as participators[1]) of companies in an insolvency process (broadly, a winding up, administration, receivership, strike off, CVA or Part 26 scheme of arrangement) or companies at serious risk of entering such an insolvency process.[2] The provisions do not apply to companies that enter the new moratorium under Part 1A of the Insolvency Act 1986 or the Part 26A Restructuring Plan (as introduced under the Corporate Insolvency and Governance Act 2020).[3]

A joint liability notice may still be given when the relevant company has ceased to exist, in which case the recipient of the joint liability notice shall either be solely liable for the relevant tax or jointly and severally liable for the tax along with any other individuals that also received such notice.

A summary of each heading of liability is set out below, together with highlights of potential areas of concern.

Tax avoidance and tax evasion cases

If it appears to the HMRC officer that:

1. the company has entered into:
   a) tax-avoidance arrangements[4]; or
   b) engaged in tax-evasive conduct[5];
2. the company is subject to an insolvency procedure (as defined above), or there is a serious possibility of the company becoming subject to an insolvency procedure;
3. there is, or is likely to be, a tax liability referable to the tax-avoidance arrangements or to the tax-evasive conduct; and
4. there is a serious possibility that some or all of the relevant tax liability will not be paid,

then a notice may be issued to:

1. a director, shadow director or participator of the company if it appears to the HMRC officer that such person:
   a) was responsible (whether alone or with others) for the company entering into the tax-avoidance arrangements or engaging in the tax-evasive conduct, or
   b) received a benefit which, to the individual's knowledge, arose (wholly or partly) from those arrangements or that conduct;

   (the "first limb offence"); or
2. a director, shadow director or individual concerned, or taking part, in the management of the company, who it appears to the HMRC officer, took part in, assisted with or facilitated the tax-avoidance arrangements or the tax-evasive conduct (the "second limb offence").

A notice may therefore, be issued before any tax liability has crystallised and before there is certainty that the company will in fact enter into an insolvency procedure and will be unable to settle the tax liability. Whether and when a notice is issued will be determined by a judgment call of the responsible HMRC officer on his or her evaluation of the available information at the time.

An individual who is given a notice is jointly and severally liable with the company (and with any other individual who is given such a notice) for the relevant tax liability.

In respect of the first limb offence:

1. the criteria for determining whether an individual is "responsible" for the relevant tax avoidance or evasion is unclear, and may be interpreted to cover a passive responsibility resulting from a position or job title, or from an actual responsibility arising from actual involvement/engagement with the arrangement or conduct; and
2. the term "benefit" is not defined, is not limited by reference to a *de minimis* threshold, and could be construed widely. Although this part of the first limb offence is qualified by the director, shadow director or participator knowing that the benefit arose from the relevant arrangements or conduct, it is not clear whether the individual must have known that the arrangements or conduct constituted tax avoidance or evasion. Guidance is given however, in respect of the state of the individual's knowledge: he or she is to be treated as knowing anything he or she could reasonably be expected to know, but whether that reasonable requirement is subjective or objective is not clarified.

In respect of the second limb offence:

1. there is no requirement that the relevant individual had knowledge at the time that the arrangements or conduct constituted tax avoidance or evasion; and
2. there is no clarification as to what "taking part in" or "assisting with" actually means. As drafted the provision is arguably wide enough to capture someone whose only involvement would be submitting the relevant forms with no knowledge of any wrong doing, whilst the

actual arrangements or conduct were fully carried out/undertaken by others.

Given the above, and without any case-law to give guidance, it is not unforeseeable that a director, shadow director or manager in a complicated group structure with no real visibility into the tax affairs of the company could be caught by the legislation.

Repeated insolvency and non-payment cases

This set of provisions is primarily intended to capture phoenix type cases where directors or shareholders use insolvency procedures to leave tax liabilities behind in the "old" company, and continue to trade the same business in a new company, satisfying liabilities to key creditors required to keep the business afloat. However, there is potential for these provisions to have a greater impact.

An HMRC officer may serve a joint liability notice on an individual if it appears to her/him that:

1. there are at least two companies (the "old companies") of which the individual was a director, shadow director, or a participator at any time during the five years ending with the day notice is given (the "five year period"), which have been subject to an insolvency procedure at any time during the five year period and, in each case, at the time when the company became subject to such procedure the company had:
   - a) a tax liability, or
   - b) failed to submit a return or other document, or to make a declaration or application it was required to make in relation to the tax liability and its quantum, or
   - c) submitted a return or other document, or had made a declaration or application, but an act or omission on the part of the company had prevented HMRC from dealing with it;
2. another company (the "new" company) is or has been carrying on a trade or activity that is the same as, or is similar to, a trade or activity previously carried on by each of the old companies or any two of them (if there are more than two);
3. the individual is or was a director, shadow director, or a participator or is concerned, whether directly or indirectly, or took part in, the management of the new company at any time during the five year period; and
4. at the time the notice is given, at least one of the old companies has a tax liability and the total amount of the tax liabilities of the old companies is greater than £10,000 and more than 50% of the total amount of those companies liabilities to their unsecured creditors.

The HMRC officer has two years to issue the notice beginning on the date that HMRC first became aware of facts sufficient for them reasonably to conclude that the conditions are met.

In such circumstances, any individual who receives the notice is jointly and severally liable with:

1. the new company for any tax liability that the new company has (a) on the day on which the notice is given and (b) during the five years beginning with the day notice is given and while the notice continues to have effect; and
2. the old company for any tax liability of the old company on the day the notice is given.

Therefore, liability could potentially be triggered where only one old company met the requisite liability threshold and, for example, one other old company had by administrative oversight failed to submit its tax return. There is no requirement for the director concerned to have had direct knowledge of such oversight or the tax affairs of the company, or have been involved with the relevant companies at the time the relevant events took place or indeed when the insolvency procedure commenced. It is not difficult to see how this could be a real issue in a complex, large group insolvency with a substantial tax liability.

When restructuring a group with significant tax liabilities, it will also be essential to consider the potential effect of any future insolvency, particularly where management are to be incentivised in any new structure with equity and/or remain in management of a newly incorporated company in some capacity and, therefore, could be caught by the legislation.

Cases involving penalty for facilitating avoidance or evasion

A joint liability notice may be served on an individual if it appears to the HMRC officer that:

1. a penalty under certain specified provisions[6] has been imposed on the company by HMRC or proceedings have been commenced before the First-tier Tribunal for such a penalty to be imposed;
2. the company is subject to an insolvency procedure or there is a serious possibility of the company becoming subject to an insolvency procedure;
3. the individual was a director or shadow director of the company, or a participator in it, at the time of any act or omission in respect of which the penalty was imposed, or the proceedings for the penalty were commenced; and
4. there is a serious possibility that some or all of the penalty will not be paid.

Any individual who is given a notice is jointly and severally liable with the relevant company for the amount of the penalty. Again, there is no requirement for the individual to have had knowledge of the underlying acts giving rise to the penalty or to have been involved with the relevant companies at the time the insolvency procedure commenced.

Responsibility of HMRC officer

It is clear that the responsibility on the HMRC officer in making a determination to issue a notice is great and significant reliance will be placed on that officer's ability to access and evaluate complex financial information, some of which may be wholly or partly unavailable due to confidentiality restrictions. In challenging financial times for companies, judgement calls around a company's solvency are difficult enough for directors, in spite of being at the coalface of the business and with the benefit of access to all the financial information and accounting/legal advice. This may discourage HMRC from invoking the new rules, which ultimately could be used as a deterrent rather than as a revenue collection tool.

Review and appeal

An individual has the right to request a review of any joint liability notice. This request must be made in writing within 30 days of the notice being given (such 30 day period being extendable by HMRC). It should be noted that the right of review relates to whether such a notice should have been issued and it is not open to the individual to challenge the existence or amount of any tax liability of a company to which the notice relates, save for in limited circumstances (as to which see below).

The nature and extent of the review will be as appears appropriate to HMRC in the circumstances, but HMRC must have regard to the steps taken by HMRC in reaching their decision and by any person seeking to resolve disagreement about the decision. There is no review by an independent body at this stage. Unless HMRC are satisfied that the individual had a reasonable excuse for not applying for a review within 30 days, the decision in the notice will be without further review and the individual's liability will be fixed. It will therefore be important for any affected individual to be advised in a timely manner of their right to review.

At the conclusion of the review, HRMC must set aside the notice if it appears to them that (i) any of the relevant conditions are not met or (ii) it is not necessary for the protection of the revenue for the notice to continue to have effect (if set aside for this latter reason, the individual will not have a right to receive any amounts already paid to HMRC in response to the notice). The notice must also be set aside or varied if the amount demanded appears to HMRC to be incorrect.

There is also a 30 day period within which a joint liability notice may be appealed to the First-tier Tribunal (the "Tribunal"), starting with the day on which the notice was given (or a later date if extended by HMRC) or the date on which HMRC communicates its conclusions of a review (if applicable). If a review has been declined by HMRC (which they are entitled to do if an appeal is made in parallel with a request to review) the Tribunal's permission is required for appeal.

The grounds for the Tribunal setting aside or varying the notice are similar to those for HMRC to consider when undertaking a review, otherwise the Tribunal must uphold the notice.

There is no ability for the individual to appeal the tax liability itself unless the company is subject to an insolvency procedure and does not make an appeal in respect of that liability, and such appeal must be made within 30 days of the notice. The individual may also join any appeal in respect of the liability by the company (if the company is subject to an insolvency procedure) and continue the appeal if the company is unwilling or unable to do so.

Withdrawal of notice

There are various circumstances under which HMRC may withdraw or modify the notice. For example, HMRC must withdraw the notice if it is not necessary for the protection of the revenue for the notice to continue to have effect (but note that the individual has no right to recover monies paid prior to withdrawal in these circumstances) or any of the relevant conditions were not met when the joint liability notice was given.

HMRC has absolute discretion to withdraw a notice by giving further notice if it thinks it appropriate to do so. This is not restricted to the outcome of any review, but it is not clear in what other circumstances a decision to withdraw would be made. HMRC may also amend the amount demanded under the notice (including by increasing the amount).

Conclusion

Given the significant potential liability for directors and other individuals, these provisions must be considered in the context of any restructuring or insolvency involving significant HMRC liabilities. It will be imperative for directors, management and their advisors, particularly in the restructuring space, to be aware of the very serious ramifications of these provisions.

There will be an increasing incentive and internal pressure for directors to play an active part in ensuring good corporate governance and rigorous accounting practices in their companies. We may also see a rise in the resignation of "good" directors from boards, including those who are considered to have some expertise in insolvent situations, who feel exposed whether due to the company's current or historic practices and management structure, or because they are unable to gain the necessary information or comfort around their level of risk. Somewhat ironically, the spectre of large-scale resignations means that the provisions may provide an initial set back to the government's policy of pursuing better corporate governance in large, complex group structures.

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1. For a full definition of who would qualify as a participator, see s454 of the Corporation Tax Act 2010.
2. The rules also apply to limited liability partnerships (as defined in the s1121 of the Corporation Tax Act 2010) and their members (and shadow members). For the sake of brevity, references in this article to "company" or "companies" should also be taken to refer to "limited liability partnership" or "limited liability partnerships".
3. A moratorium and restructuring plan are not caught by the definition of insolvency procedure in paragraph 8 of Schedule 13.

4. Defined by reference to various established anti-avoidance rules (including, for instance, rules relating to the disclosure of tax avoidance schemes (DOTAS) or the general anti-abuse rule (GAAR)).
5. Defined as (i) giving to HMRC any deliberately inaccurate return, claim, document or information, or (ii) deliberately failing to comply with various obligations set out in Sch 41 of the Finance Act 2008 (obligations to notify liability to tax, etc.).
6. Defined by reference to various established anti-avoidance rules (including, for instance, rules relating to DOTAS or the enabling of tax avoidance).

If you would like more information about the topics raised in this briefing, please speak to your regular contact at Weil or to any of the authors listed below.

Oliver Walker	View Bio	oliver.walker@weil.com	+44 20 7903 1522
Natasha Ayres	View Bio	natasha.ayres@weil.com	+44 20 7903 1497
Ellie Marques	View Bio	ellie.marques@weil.com	+44 20 7903 1408

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