By email to: ca.consultation@hmrc.gov.uk

22 June 2023

**Consultation: Tougher consequences for promoters of tax avoidance (the Consultation)**

This is the joint response to the Consultation of the Insolvency Lawyers' Association's Technical Committee and the CLLS Insolvency Law Committee.

By way of background, the ILA provides a forum for approximately 500 full, associate, overseas and academic members who practise restructuring and insolvency law. The membership comprises a broad representation of regional and City solicitors, barristers, academics and overseas lawyers. The Technical Committee of the ILA is responsible for identifying and reporting to members on key developments in case law and legislative reform in the insolvency and restructuring market place.

The CLLS represents approximately 17,000 City lawyers, through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees, including the Insolvency Law Sub-Committee, made up of solicitors who are expert in the field.

**Introduction**

On 27 April 2022, HMRC launched the Consultation, seeking views on proposals which would, if implemented, buttress its ability to tackle promoters of tax avoidance. We should state at the outset that we agree with the overall tenor of the Consultation and the mischief it seeks to address: that those responsible for promoting tax avoidance schemes contrary to the legislative framework ought to be held accountable.

We have limited our response to points raised in the Consultation relating to the expedition of disqualification proceedings against directors of companies involved in promoting tax avoidance. We do not address in any great detail the proposal to introduce a new criminal offence for promoters who fail to comply with a Stop Notice.

We have also taken this opportunity to highlight a number of general practical issues that may merit further consideration, and while we appreciate that HMRC intends to liaise with the Insolvency Service in developing its proposals (as acknowledged in section 4 of the Consultation – "*Assessment of impacts*"), coordination and dialogue needs to be factored into the considerations at an early stage. In particular, we are concerned that the introduction of the new expedited route to

disqualification might give rise to significant amount of duplication in the investigation of the conduct of directors and potentially lead to competition for recoveries. In this respect we are concerned that where directors may be pursued both under the expedited regime and under the existing regime set out in the Companies' Directors Disqualification Act 1986 (CDDA), there will be a tension between applicable penalties under the new regime and any compensation order awarded under s15A of the CDDA.

There is also potential for procedural overlap with any proceedings that are launched in connection with formal insolvency processes (e.g., fraudulent or wrongful trading or misfeasance).

We are of the view that the expedition of disqualification proceedings should not be used as a mechanism to elevate the position of HMRC in a formal insolvency process or otherwise prejudice other stakeholders.

**Questions 1 to 5 (the imposition of a criminal sanction for failing to comply with a stop notice)**

As mentioned above we have limited our specific response to the proposal for expedited disqualification proceedings relating to those involved in promoting tax avoidance schemes. We do however note that the proposal to impose criminal sanctions for failing to comply with a Stop Notice needs to be carefully balanced against the existing civil regime. We were concerned as a general point that the proposals impose a strict liability and appear to allow the criminal sanction to stand, even if at a later point the scheme is validated, i.e., it is found not to be an avoidance scheme.

It may be that we have also misinterpreted what is intended at paragraph 2.17 of the Consultation regarding the availability of a reasonable excuse for not complying with a Stop Notice. The Consultation suggests that both an open appeal against a Stop Notice and ongoing litigation of a tax avoidance scheme would not constitute a reasonable excuse, and there is no mention of any potential remedy for losses that may have been incurred as a result of a Stop Notice being issued inappropriately in respect of genuine tax planning. Also, the safeguards, which primarily rely upon a challenge being launched by the recipient following a Stop Notice being issued (absent a request for it to be withdrawn or suspended being granted), might not be sufficient to protect those who have been wrongly accused and subject to the new criminal sanctions (all of which are imposed and adjudicated upon by HMRC). While the Consultation indicates that the criminal offence will be reserved for the most serious cases, and the exercise of HMRC's criminal investigation powers will be subject to review by managers and assurance teams who are to be independent from operational units, there is a risk that HMRC's exercise of these new powers, combined with the imposition of the new criminal sanction, could lead to inappropriate use of these new measures.

We also query whether the current proposals are a proportionate response to a problem which is identified in the Consultation as being attributable to the actions of between just 20-30 active promoter organisations (paragraph 1.3), although we also appreciate that the lost revenue is significant - albeit much reduced from previous years to £0.4bn in the tax year 2020/21. It may also be considered premature to introduce further measures while the package of measures introduced by the Finance Acts 2021 and 2022 are still at an early stage of implementation, with only 27 promoters and 31 avoidance schemes published and 10 Stop Notices served to date. We think it might be advisable to assess the effectiveness of these measures before taking further action.

In addition, we think there might be intermediate solutions – short of introducing a new criminal regime – which together could offer a more effective and commensurate response to the problem of tax avoidance. These solutions should focus on increasing the effectiveness of the monitoring process (so that tax avoidance schemes are identified at an early stage), implementing practical

steps towards improving HMRC's ability to identify such schemes (including making the necessary resources available) and limiting the ability for these schemes to be allowed to continue.

**Question 6: Do you agree that allowing HMRC to consider and bring disqualification proceedings against directors and those who control or exercise influence over a company involved in promoting tax avoidance will help deter and tackle tax avoidance?**

We are not entirely persuaded that the potential for HMRC to bring disqualification proceedings will necessarily deter or tackle tax avoidance in its own right. Those who are determined and focused on the financial gains to be made from promoting tax avoidance schemes may have little regard to the potential criminal sanctions and indeed, as the Consultation indicates, will look for ways around the legislation. In this respect, one could argue that the civil sanctions and financial penalties which are already in effect under the Finance Acts 2021 and 2022 may be a more effective deterrent than the threat of disqualification.

As the Consultation notes, HMRC already has the power to bring public interest winding-up petitions based on tax avoidance. The current ability to wind up a company involved in promoting tax avoidance is quite rightly the focus of the recently enhanced powers of HMRC as well as being a mischief which the ability to issue a Stop Notice aims to tackle. Both have the effect of bringing an immediate cessation to the promotion of such schemes. In our view, while we can appreciate that an additional mechanism designed to deter those involved from the continued promotion of avoidance schemes could be useful, we are also concerned that the introduction of a new power to pursue disqualification at the same time as a winding-up petition has been issued has the potential to disrupt and delay the public interest winding-up proceedings and may ultimately fail to protect the public from the harm of these schemes. This might be exacerbated in circumstances where the subject of the disqualification proceedings is someone who is 'indirectly in control or exercising an influence', as establishing their influence will be a fact specific and evidence intensive exercise.

As set out in paragraphs 3.22 and 3.23 of the Consultation, the wide range of materials HMRC will need to review when considering the case for disqualification may not be conducive to the often summary nature of the winding up process. This could result in a delay to the winding up proceedings, as the Court may be distracted by evidence relating to the disqualification which would ultimately frustrate the point of having an expedited route to disqualification in the first place. If the additional power to expedite disqualification is pursued, then the legislation should be clear that disputes in respect of the disqualification proceedings should not have a suspensory effect on the winding up proceedings.

It is also unclear from the Consultation how any competing disqualification proceedings commenced under the CDDA are to be dealt with. For example, are any proceedings commenced by the Insolvency Service, or CMA, going to be stayed? Is the Insolvency Service going to be precluded from including tax avoidance schemes as a basis of unfitness? Are HMRC going to be allowed to apply for compensation orders under s15A of the CDDA? Are separate regulations regarding the coordination between the different regulators (e.g., FCA where applicable), HMRC and the Insolvency Service going to be enacted as envisaged by S9D of the CDDA for competition cases? Are measures going to be taken to ensure that the multiple procedures do not result in delay or added costs that are ultimately borne by the public purse? In the event that separate disqualification orders are made, will these run concurrently as per s 1(3) CDDA?

Also, it is unclear how allowing disqualification proceedings to be issued against live companies in these circumstances, instead of simply winding them up first in the public interest, would function as

a deterrent and help tackle tax avoidance. Introducing such measures might also inadvertently undermine genuine attempts to rescue distressed businesses.

The Consultation suggests that by disqualifying the director first, this would also lead to the company being wound up or struck off because it would not have any directors. This assumes that companies only have one director, which is not always the case, and even in instances where all the directors are disqualified, substitutes could be appointed. Furthermore, even in circumstances where there is an absence of directors, this may not result in an immediate winding up or striking off. Also, it is unclear from the Consultation which Court would be allocated jurisdiction. We are of the view that the ICC would be best placed as they are used to dealing with disqualification proceedings more generally. Although, we are not persuaded that this aspect of the proposal should be pursued and practically speaking we consider that it would be difficult to successfully enforce.

The use of the existing public interest winding up mechanism remains in our view the most effective and efficient way of limiting the future impact of avoidance schemes. We would also be concerned if the automatic disqualification provisions (as applicable to bankrupts) would apply in respect of live businesses (as paragraph 3.20 of the Consultation seems to suggest). This is contrary to the overall tenor of the Consultation.

**Question 7: What other factors should HMRC take into account when considering a director disqualification?**

Given that there are already other grounds for disqualification under the CDDA, we think that the factors for disqualification under these proposals should be confined to a failure to comply with the avoidance rules. We do not for example consider it appropriate for HMRC to expand its considerations to include general lack of compliance with all tax legislation - it is unclear, from paragraph 3.22 of the Consultation, whether this is a factor HMRC will consider when assessing the case for disqualification. We also consider that the making of a public interest winding up order may provide a useful gateway to such proceedings and therefore as mentioned above we are not persuaded that HMRC should be afforded the ability to pursue live companies.

**Question 8: Do you have any suggestions for ensuring these proposals deal effectively with those who directly or indirectly control or exercise influence over a company, for example shadow directors?**

HMRC could consider the same approach as currently applies to the regime relating to the disqualification for competition infringements as set out in sections 9A to E of the CDDA. This includes shadow directors as per S9E of the CDDA.

**Question 9: Should undertakings form part of HMRC's approach to director disqualification?**

No.

While undertakings may be appropriate in certain cases, they also have the potential to result in injustice. For example, under the current system of disqualification, the costs of seeking appropriate advice and defending proceedings at Court can in practice mean that individuals accept undertakings in circumstances where the case for unfitness is not necessarily made out against them. The acceptance of the undertaking is driven by the costs, time, and stresses of challenging the allegations. In circumstances where the proposed HMRC director disqualification process is based on tax avoidance claims which are adjudicated upon by HMRC (in contrast to other disqualification

proceedings which are largely based on an independent report by an insolvency practitioner in respect of directors' conduct), we do not think the use of undertakings is appropriate.

We are of the view that the Court in the context of the present proposal should play a vital role to ensure that HMRC satisfies the evidential burden for disqualification. We do not think it is appropriate in such circumstances to have undertakings in respect of breaches of the tax avoidance legislation, especially where potential criminal sanctions may also be imposed. In this respect the Court would play a vital role in ensuring that due process and fairness is adhered to.

Of course, we also recognise that by limiting the expedited process to Court orders only this does come with the attendant need for further resources at Court and this should be factored into the impact assessment. As mentioned above, further thought should be given to how the cases are allocated and ensure the Courts are well resourced. We consider that the ICC may be best placed to deal with such matters. These are fundamental aspects of the proposals that need to be carefully assessed.

**Question 10: Do you consider the current sanctions for breaching a disqualification or undertaking are sufficient for tax avoidance-related disqualifications?**

We agree that the current sanctions that are available and applicable for breaching a disqualification order/undertaking appear to be appropriate and have the advantage of already being well understood by practitioners and the Courts.

**Question 11: Do you consider the current safeguards outlined above are sufficient and provide adequate protections for directors? If not, what additional safeguards could be introduced?**

We think that it is important that the safeguards and protections under the expedited disqualification process include the right to make representations, to appeal decisions, and the ability to apply to Court for leave to act as a director. We are also pleased to see the acknowledgement in the proposal that HMRC needs to have robust internal governance, and as mentioned above the Court therefore plays a crucial role in the safeguarding process. We suggest any appeals and representations be reviewed by a panel within HMRC to ensure consistency. We also consider that there ought to be a strict time limit for the panel's response. As recognised in the Consultation and mentioned above, adequate resources need to be made available to facilitate an efficient decision-making process before introducing further powers.

We would be very pleased to discuss further any aspect of our response. Please contact:

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