

Who pays the debt?

Patrick Cannon looks at how HMRC is attempting to recover unpaid PAYE and National Insurance in relation to employee benefit trusts from the directors of insolvent companies.

HMRC has been busy of late lodging proof of debts in the liquidation of companies that cannot pay their PAYE and National Insurance liabilities in relation to employee benefit trusts (EBTs). These are companies affected by the Supreme Court decision in *RFC 2012 plc* [2017] STC 1556 that monies paid into such schemes were subject to tax. In response, the liquidators are vigorously pursuing the directors of these companies for monies paid into such trusts, going back to 2002, to satisfy HMRC's proofs of debt.

“Two recent decisions of the Insolvency and Companies Court have reached contradictory conclusions.”

Two recent decisions of the Insolvency and Companies Court have reached contradictory conclusions on this issue. *Allen and Carton-Kelly as joint liquidators of Vining Sparks UK Ltd v Bernard and others* [2019] EWHC 2885 (Ch) held that the liquidators' claim failed, while the other, *Toone and Paorov (as joint liquidators of Implement Consulting Ltd) v Ross and Bell* [2019] EWHC 2855 (Ch) upheld the liquidators' claims.

The opposite conclusions in cases that share the same basic fact patterns are at first surprising. However, the key to understanding why this came about lies in the way in which the liquidators formulated their claims.

Vining Sparks

This was the case in which the liquidators' claims against Mr Bernard failed. In short, the reason for the failure of the claim was that he had not been subjectively dishonest when

Key points

- Liquidators are pursuing directors of insolvent companies to pay HMRC.
- In *Vining Sparks*, the court found the director had acted in good faith.
- The judge in *Implement Consulting* found the employee benefit trusts payments to be distributions.
- Further appeals may be a possibility.



© iStockphoto/Witayawit Prasongpan

he participated as a director of the company in setting up and approving payments into the EBTs.

The liquidators principally framed their claim against Mr Bernard for compensation, damages or a contribution to the assets of the company. They alleged that he acted in breach of his duties under Companies Act 2006, s 172 to promote the success of the company as a director. This caused the company to evade its PAYE and National Insurance liabilities in relation to the payments into the EBTs and, further, that he had acted dishonestly in doing so. Dishonesty was expressly pleaded.

In a comprehensive analysis of the relevant history and facts surrounding the company's EBTs, including the involvement of the promoter, Paul Baxendale-Walker, the judge found that Mr Bernard had relied upon professional advice and a general awareness of the taxpayer wins in *Sempra Metals Ltd* (SpC 698) and the decisions of the First-tier Tribunal and the Upper Tribunal in the *RFC 2012 plc* case. So he had genuinely believed that the relevant payments were not subject to PAYE and National Insurance. Nor had Mr Bernard failed to act in good faith. Moreover, the schemes were operated as they had been intended to and were not shams.

Therefore, the liquidators' claim that there had been a dishonest or bad faith failure to deduct, account for and pay over PAYE and National Insurance to HMRC in breach of his duties under Companies Act 2006, s 172 was dismissed.

Implement Consulting

In this decision, the liquidators succeeded in their application against the respondent directors. But the respondents were also the shareholders who owned 80% of the company. Hence, the liquidators' claim was that the aim of the schemes was to strip out the distributable reserves of the company by paying the monies into EBTs which then made tax free payments to the shareholder employees.

The judge found that although the payments to the respondents were made through the EBTs, they were on the facts of the case, in substance, distributions. Moreover, because of a failure to comply with the Companies Act, the

distributions were unlawful and had to be paid back. The judge decided that, on a realistic assessment of the facts, the payments were not reasonably incidental to the carrying on of the company's business, nor for its benefit, nor to promote the prosperity of the company. Hence, the payments through the EBTs were to be recharacterised as a return of capital to shareholders. To enable that to occur, formalities are required by the Companies Act 2006, Pt 23. However, these were not observed and the returns of capital were therefore unlawful. Under s 847, if a member knows or has reasonable grounds for believing at the time that a distribution is unlawful, he must repay it to the company.

Conclusion

Vining Sparks is a robust decision, particularly because the director relied mainly on the advice of Mr Baxendale-Walker who was also the promoter of the scheme, and did not take independent advice. In *Implement Consulting*, the director/shareholders also failed to take any independent advice or read the opinions of leading counsel provided to the scheme promoter, but were strongly criticised by the judge for failing to do so and this, in his view, undermined their position.

The difference in the conclusions of the two cases may be explained by the following factors:

- The director in *Vining Sparks* was not also a shareholder and so did not receive the monies as such, so the unlawful distribution point was not taken against him.
- The case against him was put highly by the liquidators in terms of him having been dishonest or acting in bad faith as a director but they failed on the evidence to establish that this had been the case.
- The judge in *Implement Consulting* appears to have been rather unsympathetic towards what he referred to as 'profit extraction schemes', whereas the judge in *Vining Sparks* took a more balanced view and even began his decision by quoting Lord Tomlin in *CIR v Westminster* 19 TC 490: 'Every man is entitled if he can to order his affairs so as that

the tax attaching under the appropriate Acts is less than it otherwise would be.'

- It appears to have been easier for liquidators to establish that an unlawful distribution has occurred, followed by strict liability to repay it, compared with establishing a dishonest or bad faith failure by a director to promote the best interests of his company.

In discussing the *Implement* case with *Taxation's* editor-in-chief and others it becomes clear that there is an anomaly at the heart of the decision. If the amounts involved really were distributions then it would follow there would be no PAYE and National Insurance liabilities for the company to account for. Therefore there would have been no liability to HMRC and hence the company would not have become insolvent. A liquidator would not have been appointed and so there would have been no challenge to the validity of the 'distributions' to the shareholders. So everything would have remained in place. The individuals would have a personal tax liability on the 'distributions' – assuming HMRC had the power to assess – but that would not be an issue for the company. (The corporation tax relief given to the company would have to be withdrawn but it does not appear that that would, in itself, have been enough to put the company into insolvency.) So everything seems to have gone round in a circle. If there is an appeal I would hope that this point would be properly considered because it does not appear from the published judgment that this aspect was taken into account at first instance.

We may not have heard the last of this, because appeals in each case are a possibility, and there are likely to be other similar cases working their way towards trial. ●

Author details

Patrick Cannon is a barrister at Old Square Tax Chambers and can be contacted at: www.patrickcannon.net.



Planning point

If the liquidators of insolvent companies are making claims against directors and shareholders, ensure that the exact nature of any alleged unlawful withdrawals as well as the tax and National Insurance implications are fully understood.

FIND OUT MORE On Taxation.co.uk

- Implications of the *Rangers* decision: tinyurl.com/y6qyg80k
- Disguised remuneration and the loan charge rules: tinyurl.com/y5qb9uum

Bruce Sutherland & Co

Share valuation specialists

"The estimation of the value of a share in a company whose shares cannot be bought and sold in the open market, and with regard to which there have not been any sales on ordinary terms, is obviously one of difficulty."

Lord Fleming in *Salvesen's Trustees v IRC* [1930]

B W Sutherland CBE FCA FTII
Miss J A Nelder BA FCA FTII
David Bowes FTII MAE EWI

Moreton House, Moreton-in-Marsh, Gloucestershire GL56 0LH
Tel: 01608 651091 Fax: 01608 651973 DX 11484 Moreton in Marsh

bruce.sutherland@bruce-sutherland.com jenny.nelder@bruce-sutherland.com david.bowes@bruce-sutherland.com