

## ICAEW TAX FACULTY REPRESENTATION

### TAXREP 6/11

### SECURITY FOR PAYE AND NATIONAL INSURANCE CONTRIBUTIONS

*Comments submitted on 9 February 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales to HM Treasury in response to a consultation document issued on 9 December 2010 by HM Revenue & Customs*

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# SECURITY FOR PAYE AND NATIONAL INSURANCE CONTRIBUTIONS

## INTRODUCTION

1. In this document we present the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) to the above-named consultation document published by HM Revenue & Customs (HMRC) on 9 December 2010 at [www.hmrc.gov.uk/budget-updates/autumn-tax/payee-nics0925.htm](http://www.hmrc.gov.uk/budget-updates/autumn-tax/payee-nics0925.htm).
2. We are pleased to have the opportunity to respond to this consultation. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. On 3 February 2011 we attended a meeting with HMRC in which we were able to put forward some key comments and concerns and discuss aspects of the discussion document.

## WHO WE ARE

4. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
5. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
6. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals to change the tax system.

## MAIN POINTS

7. We are concerned that the offence of failure to provide security could be used against businesses which cannot pay having overstretched themselves by growing too quickly or taking on too much risk or are simply not very good at looking after their finances, rather than those that won't pay because they are wilfully trying to evade their obligations. A businessman in the former situation should not face a criminal record.
8. HMRC will need to ensure that its administration of the new regime for PAYE/NIC is proportionate – the requirement for proportionality in the context of requiring security is confirmed by European Court of Justice cases – and must distinguish between the can't payers and the won't payers, which may not necessarily be a simple task.
9. We acknowledge that the structure of PAYE is that most of its rules are in the PAYE Regulations but in the absence in the draft Finance Bill legislation of any specification of the conditions that must be met for security to be demanded, we consider that the primary legislation should include an important safeguard, namely that a Commissioner of HMRC should be responsible for

for issuing a demand for security. We should also welcome a Ministerial assurance that a senior HMRC official will not only sign off but manage cases for which the issue of a demand for security is being considered

10. As noted below there are numerous additional safeguards which should be included in the regulations, for example the size of security should match the PAYE/NIC at stake, the time given to provide security needs to take into account the circumstances of the case and the obligation to provide security needs to be suspended pending an appeal.
11. Questions which are not asked in the consultation document or in the tax information and impact note are, first, whether there is a need for this proposed regime to demand security that can be justified by reference to anticipated exchequer yield and, secondly, whether there are existing powers which HMRC could use to increase receipts.
12. As to the first point, we question on the basis of the data provided in the condoc whether the anticipated gain to the exchequer as a proportion of the estimated tax and NIC being lost warrants the introduction of a new regime of this nature. This is apart from the costs of implementation and running costs for HMRC and additional administrative costs and burdens for employers, let alone innocent employers, which will be created if HMRC's administration of the new regime is not proportionate, efficient and fair.
13. The consultation document states at para 1.7 that the exchequer lost an estimated £600-800 million per year between 2005/06 and 2008/09 in PAYE/NIC debts built up by employers which became insolvent, and envisages at para 3.12 (reaffirmed in the tax information and impact note) that a security requirement would give rise to an anticipated annual yield of £5 million. On the basis of an annual exchequer loss of the average of £600m and £800m divided by the annual expected gain of £5m, a percentage recovery of less than 1% does not seem very much, but we understand from discussions with HMRC that the real anticipated exchequer yield from this measure will be in the region of £150 million pa and the £5m is the product of a formula which in this case does not give a true picture.
14. As to the second point, HMRC is, rightly, concerned about employers which do not pay the PAYE/NIC that they owe having deducted it from employees' emoluments, and in particular phoenixism, ie businesses which become insolvent and then restart with largely the same individuals in control. We suggest therefore that HMRC could make more use of the existing powers at its disposal, notably section 121C Social Security Administration Act 1992 which was implemented with phoenixism in mind and gives HMRC the power to impose a 'personal liability notice' on a director or other officer of a corporate body which has failed to pay the NIC as a result of the fraud or neglect of that individual. If section 121C is considered too restrictive owing to its covering only NIC due from corporate bodies then we recommend that it be amended.
15. HMRC could also use the Theft Act 1968, and make inquiries of employers whose patterns of PAYE/NIC remittances look abnormal (which latter course of action we assume is happening in connection with ensuring that the new late-paid PAYE penalty regime is encouraging prompt payment).
16. ICAEW does not condone actions by members that would give rise to a need for HMRC to demand security. We should therefore welcome HMRC using the public interest disclosure gateway in section 20 Customs and Revenue Commissioners Act 2005 to enable us to investigate the professional conduct of such people and thereby help us to maintain the high standards that we expect of our members.
17. Finally, as noted in our reply to Question 2, the truncating into one concurrent stage of the government's new three stage tax policy making approach published at Budget 22 June 2010 as *Tax policy making: a new approach* [http://www.hm-treasury.gov.uk/d/junebudget\\_tax\\_policy\\_making.pdf](http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf) conflicts with both the terms and the spirit of the government's aim to have a more considered approach to tax policy making.

## ANSWERS TO SPECIFIC QUESTIONS

**Question 1:** *Is there a civil sanction that could be designed which would have the necessary impact on determined rule breakers?*

18. If the deterrent effect of a sanction whether criminal or civil changes in a desired manner the behaviour of those at whom it is aimed without needing to be used save in extreme cases then this is probably the best outcome of all, and is much better than having a toothless sanction which is used frequently but to no avail, or even a robust sanction which is not used and therefore falls way from people's consciousness.
19. In the NIC code there is already a civil sanction in Part VI Social Security Administration Act 1992. This is in section 121C, which provides that any company's NIC can be recharged by HMRC to any one or more directors and/or the company secretary by way of a 'personal liability notice' where the failure of the company to pay appears to HMRC to be attributable to fraud or neglect on the part of such individuals. This provision was introduced as a means to tackle phoenixism but has been used successfully in non-phoenix situations as illustrated in *Inzani v RCC* [2006] STC 279 SpC 529 and *L Livingstone v HMRC* [2010] UKFTT 56 TC00369. We accept that it necessitates proving the debt but as we suspect that HMRC knows who needs to be targeted, we suggest that the Department could use the sanctions at its disposal more frequently.

**Question 2:** *In view of the changes that are taking place or being consulted on which concern PAYE, HMRC would welcome views on the timing of when the ability to obtain security should be introduced.*

20. In our previous submissions on this topic (submission made on 16.2.09 in TAXREP 9/09 in response to Powers consultation document published on 24.11.08 '*Payments, repayments and debt: the next stage*', in our initial comments on the first 2010 Budget 2010 in TAXREP 21/10 and in our Parliamentary Briefing made on 6.4.10 published at TAXREP 22/10 on the 1 April 2010 Finance Bill 2010) we said that there needs to be proper consultation before such a sanction is introduced.
21. Prior to the publication of the consultation document on 9 December 2010 to which this memorandum is the response public consultation on this proposed measure had comprised a brief mention in HMRC's Powers consultation document published on 24.11.08 '*Payments, repayments and debt: the next stage*'. Since then the only public exposure of the proposals has been legislation in the Finance Bill published on 1 April 2010, withdrawn after objections by the Opposition. The consultation document which is the subject of this submission goes against the spirit and the terms of the government's new three stage policy-making approach published at Budget 2010 by running concurrently the three stages which, as noted at para 2.1 of the condoc, are supposed to comprise, at stage 1, setting out objectives and identifying options, at stage 2, determining the best option and determining the framework for implementation including detailed policy design, and, at stage 3, draft legislation to effect the proposed change. Under the new approach it is not acceptable – and is a logical impossibility – to merge the three stages.
22. In practical terms we consider that the impact of the PAYE/NIC late payment penalty regime which started from 6 April 2010 needs to be ascertained before powers to obtain security are used in practice other than in the most extreme cases even if the date of official 'go live', ie 6 April 2012, cited in the consultation document is retained. The impact of the late payment penalty regime will not be able to be ascertained until all PAYE/NIC payments for 2010/11 have been made and 2010/11 forms P35 have been processed and employers' payment patterns analysed by HMRC against total liabilities for 2010/11. It will be useful to be able to measure in isolation the effectiveness of the late-payment penalty regime as we consider that this by itself is likely to improve payment behaviour, especially once Real Time Information comes online. If HMRC can undertake the necessary processing and analysis of information and payments then in theory a 'go

live' date of 6 April 2012 for the security regime could be achievable, but given the need for new procedures to be designed and implemented, probably IT to be written and tested and staff training, in practical terms a start date of 6 April 2012 for the security regime which will not end with tears appears to us to be over-optimistic.

**Question 3:** *Is a criminal sanction at level 5 of the standard scale an effective and appropriate sanction for determined rule breakers in this context?*

23. The most important thing is that the punishment should fit the crime. We note that this is the figure used in the VAT regime but would point out that whilst £5,000 may be a relatively small amount for some, at the bottom end a fine of £5,000 may be disproportionate and levying large fines for relatively small offences in financial terms would bring the security regime – and HMRC – into disrepute. If the offence is to be monthly then, whilst a monthly penalty will doubtless prove a more effective incentive than a one-off penalty, a fine of £5,000 per month for a crime at the lower end may well be disproportionate and perhaps the level of the penalty should be capped in the legislation, such cap linked to the size of the security which has been demanded.

**Question 4:** *Should the offence operate per security or per month following the request for a security?*

24. A means of ensuring that employers pay the security promptly will be needed, which suggests that the offence should operate per month. This is course subject to the proviso that HMRC is justified in demanding security in a particular case. Where an employer disputes that security is being demanded justifiably and lodges an appeal, then we feel that the employer should not have to deposit the security pending the hearing of the appeal. If security must be paid pending the outcome of the appeal then this gives greater weight to the need for objective and proportionate criteria governing when HMRC can demand security including the need for a such a demand to be signed off at a senior level in HMRC and the meaning of 'for the protection of the revenue' in draft regulation 97N (see Questions 6 & 10).

**Question 5:** *Do you agree these are the right behaviours for HMRC to focus its attention on, or are there other behaviours that suggest a requirement for security would be appropriate?*

25. We agree that the behaviours cited are those on which HMRC should focus its attention.

**Question 6:** *Do the provisions on which employers' liabilities can be subject to a requirement for security and the persons from whom security may be sought target the measure appropriately and is the scope of the exclusions appropriate?*

*Provisions on which employers' liabilities can be subject to a requirement for security*

26. We assume that this question relates to the provision in draft regulation 97N that the regime will operate where HMRC 'consider it necessary for the protection of the revenue'. It is essential to ensure that only those for whom such a sanction is appropriate are forced to provide security. To this end there should be an explanation in the rules of, inter alia, exactly in what circumstances HMRC will demand security. Whilst we welcome HMRC's commitment in the consultation document to consult on draft guidance we feel that the meaning of 'for the protection of the revenue' is so fundamental to this proposed regime that it should be in the legislation, and it needs to be in the legislation if the Tribunals and Courts are going to be able meaningfully to consider this point.
27. As noted above, in addition there exists already legislation in the National Insurance legislation in Part VI Social Security Administration Act 1992 as well as other remedies such as in the Theft Act 1968. Where HMRC knows of employers who are not meeting their financial obligations to government so far as concerns paying promptly PAYE/NIC that is due, then the Department should take steps to enforce these existing laws.

*Persons from whom security may be sought (draft regulation 97P)*

28. We question whether a company secretary (cited in draft reg 97P(1)(b)(ii)) is an appropriate person from whom security should be required given that this is an administrative rather than a managerial or decision-making role.
29. We consider that the term 'any similar officer' in draft reg 97P(1)(b)(iii) is too vague a term for a criminal offence. Similar to what? Is an office manager, chief accountant or payroll manager similar to a director by virtue of the fact that they all make decisions?
30. We assume that draft reg 97P(1)(b)(iv) is intended to catch those who are not directors in name but in practice control the way in which the organisation is run. We acknowledge that the person who influences the decision not to pay may deliberately not be a company director or secretary in name. We suggest that if not already done then legal advice should be taken on whether the proposed wording will have the desired effect.

*Exclusions*

31. We consider that the scope of the exclusions in draft regulation 97O is appropriate to cover those for whom a criminal sanction of this nature would be inappropriate and who are likely to need help rather than punishment if they have difficulties with running a payroll and fall into arrears with paying over the PAYE/NIC. We suggest that HMRC sets up a dedicated unit to keep a kindly eye on these employers, in particular those involuntary employers who fall within draft regulation 97O(1)(d) (care and support employers).

**Question 7:** *What would be a reasonable amount of time to allow between the issue of a notice requiring security or a decision confirming such a notice and the deadline for giving the security?*

32. This depends on the facts and the circumstances of the case and the extent to which HMRC will be using this proposed weapon. We think that being required to provide security is a major sanction and this question pre-supposes that HMRC has exhausted other remedies before reaching this stage. Where the target is a phoenix company then for the protection of the exchequer speed is likely to be of the essence.
33. Where the target is an employer with a history of poor compliance then in some cases speed will be of the essence and in others help and guidance will be the appropriate remedy. We therefore trust that HMRC will exhaust other means to obtain compliance including offering help before issuing a notice to provide security. Where the target is an employer temporarily in financial difficulties – which many will be at present owing to the economic climate – then a pre-emptory demand for security may cause the employer to fail and the demise of the business and the decrease in the spending power of its laid-off employees if multiplied across the country will not help the UK's economic recovery nor will the prospect of being the subject of such a sanction if it is used indiscriminately encourage entrepreneurs to take on new employees.
34. The absence of a time to pay agreement (or a refused application) does not necessarily mean that the business is not having difficulties. The employer may not have asked HMRC for a time to pay arrangement because it is unaware or is trying to deal with the cash flow difficulties in another way. Where an employer having been asked for security chooses to close down his business then he will have to pay his staff for redundancy and their contractual notice period in which case another payment of PAYE tax/NIC will be due which suggests that a three months notice period will be necessary.
35. In some cases employers might provide the demanded security in cash but in others the employer might provide a bank guarantee. Either way, the employer may need to negotiate appropriate facilities with its bankers. Whilst speed might need to be of the essence in some cases, the overriding principle should be that the regime is administered in such a way as not to prejudice the commercial viability of the employer. This means that sufficient time should be allowed to enable

the employer who needs to provide security to either raise the cash or obtain a guarantee from his bankers. We suggest that HMRC liaises with the banking industry on how long this takes in practice.

**Question 8:** *Do the safeguards in the regulations strike the right balance between protecting taxpayers and tackling the behaviour of determined rule breakers?*

36. We feel that the regulations need to include some additional protections, as follows.
37. Where the employer would have passed the tests to be in a 'time to pay' agreement, then we feel that they should not be subject to a demand for security and that this should be provided for in the legislation. We suggest that draft regulation 97O would be the appropriate place for this. In this connection we would note that members report that clients in time to pay arrangements sometimes continue to receive demands for payment from HMRC; we therefore feel that including this safeguard in the legislation would help to discourage HMRC from demanding security from employers in time to pay arrangements.
38. Draft reg 97T should specify by when HMRC must release the security once an application under draft reg 97S has been successful rather than leaving the Department to 'make such arrangements as it seems fit'.
39. We note the 30 day time limit in draft regulation 97V(3) by which an appeal should be lodged. Whilst we acknowledge that for those in the tax profession 30 days to lodge an appeal is widely known to be the normal time limit, we recommend that as those cited in draft regulation 97P as being parties on whom such a notice might be served are unlikely to be tax professionals, draft regulation 97Q(1) should include as information to be included in a notice of a requirement for security the date by which an appeal must be made and how to make an appeal including who to send it to (which should be to the tribunal service although we can see no reason for HMRC not to request that a courtesy copy is sent to them).
40. The legislation should specifically say that once an appeal is made, the obligation to give security is suspended until the time to be cited in draft reg 97V(7)(a).
41. The company should have a right of appeal in draft reg 97V if the security requirement is imposed on an officer. A good employer should bear the cost of such an appeal but if the company has no right of appeal then the company appealing on behalf of the officer would create a benefit-in-kind on the officer.
42. See also Question 10.

**Question 9:** *Is the VAT guidance a suitable starting place for drafting guidance?*

43. The VAT guidance in Notice 700/52 (December 2010) could form a useful starting point but we feel that the guidance needs to be more detailed than Notice 700/52 and should include statutory references to enable users and their advisers more easily to cross refer to the legislation from which the guidance derives. (We suggest that consideration be given to these points when next updating Notice 700/52.)

**Question 10:** *Are there any other safeguards that would be appropriate in either the legislation or guidance?*

*Safeguard needed in primary legislation*

44. The primary legislation in the Finance Bill is enabling legislation with the detailed provisions in the PAYE Regulations. We accept that this is in keeping with the legislative structure of PAYE, which is largely governed by secondary legislation, and that the security provisions will not come into effect until at least April 2012. HMRC has assured us that it will continue to consult on the form of

the regime and the content of the secondary legislation and will be exposing draft guidance for comment. In the light of the above we have only one recommendation to make on the draft Finance Bill legislation.

45. We are concerned that a criminal offence, which is not fully defined in the primary legislation, will be contained in secondary legislation without any safeguards in the primary legislation. This means that Parliament will not have an opportunity to scrutinise the nature of the offence in detail.
46. Another concern is that the offence of failure to provide security is an absolute offence, so that the new regime could be used against businesses which cannot pay, for example because those businesses have taken on too much risk or overstretched themselves, rather than won't pay because the businesses want to evade their obligations. A businessman in the former situation should not face a criminal record.
47. Given that the government wants to encourage business, and in particular new and growing businesses, there is a need to ensure that HMRC distinguishes between employers who have fallen into PAYE/NIC arrears having overstretched themselves through taking too much risk or growing too quickly and those which are deliberately seeking to avoid paying what is due. Drawing this distinction will be difficult for HMRC.
48. We do feel that given that the draft Finance Bill legislation does not specify the conditions that must be met for security to be demanded, the primary legislation should include an important safeguard, namely that a member of the Board of HMRC should take responsibility for issuing a demand for security. We therefore recommend that in new item 4B in subsection (2) after the word 'required' should be added the words 'by a Commissioner of HMRC'. We should also welcome a Ministerial assurance that a senior HMRC official will manage cases for which the issue of a demand for security is being considered

#### *Other safeguards*

49. The most important non-statutory safeguard is that HMRC needs to ensure that its administration of the new regime for PAYE/NIC is proportionate. Whilst this is not necessarily something that can easily be included in the draft legislation on which we are asked to comment, in UK law this would stem from HMRC's *Your Charter* at <http://www.hmrc.gov.uk/charter/> which has statutory authority. HMRC's administration of the new regime needs also to be based on accurate information about both whether the employer can't pay or won't pay and the amount that is due.
50. The requirement for proportionality is confirmed by European Court of Justice case law, so that an imposition by the tax authorities is likely to be ultra vires if, for example, a demand for security is for an excessive amount (*Alicja Sosnowska and Dyrektor Izby Skarbowej we Wrocławiu Ośrodek Zamiejscowy w Wałbrzychu – Case C-25/07*) or is likely to cause irreparable damage or economic or social difficulties to those from whom demanded (*Bernd Giloy and Hauptzollamt Frankfurt am Main-Ost – Case C-130/95*) or it is requiring payment of excessive amounts of tax in advance (*Maurizio Balocchi and Ministero delle Finanze – Case C-10/92*). We therefore consider that the regulations should contain a formula for setting the amount of security that can be demanded.
51. As noted above, the offence is an absolute offence. This is in contrast to the offence for not providing VAT security, where the offence is continuing to trade without having provided the security. A businessman faced with having to provide security for VAT can choose to make no more supplies and close down his business, whereas an employer who has to provide security and who chooses to close down his business will still have to pay notice and redundancy. We appreciate that it may difficult for HMRC accurately to determine whether an employer can't pay or won't pay. We feel that the regulations should distinguish between these two classes of employer, so that demands for security are not made which then have to be withdrawn having caused unnecessary distress to employers who are guilty not of wilfully not paying or of paying late what they owe but are simply not very good at managing their finances or have overstretched themselves.



52. Accurate information about employers' PAYE/NIC liabilities is at present only available to HMRC on an annual basis via end of year returns P35 and P14 supplemented by what might be described as circumstantial evidence provided by monthly remittances received by Accounts Offices, and particulars obtained if HMRC makes specific inquiries of employers. It will be more readily available once Real Time Information comes on stream which the *Improving the Operation of PAYE: Collecting RTI* consultation document published on 3 December 2010 suggests will cover all employers by October 2013, although for employers who do not pay employees via BACS and who therefore will be in effect completing their RTI returns independently from the payment instructions we recommend that HMRC checks the accuracy of the information received as part of the checks that would prudently be carried out before issuing a demand for security.
53. See also Question 8.

PCB

9.2.11

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### THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://master.icaew.co.uk/en/technical/tax/tax-faculty/tax-guidance-notes>).