INSOLVENCY UPDATE

MESTON REID & Co
CHARTERED ACCOUNTANTS

Introduction

This is the last Update in 2019 and it is fitting that the Meston Reid & Co insolvency team express their thanks to all those who have referred work over the last 12 months.

The Personal Service Company : RIP?

There has been significant media comment in recent months regarding the tax position of a personal service company "PSC" : the type that tend to proliferate in the oil and gas sector. Income tax regulation 35 "IR35" aims to remove the perceived tax advantages of providing services via a PSC for individuals who cannot demonstrate that they are genuinely in business on their own account i.e. carrying the risks and rewards of being self employed. If IR35 applies, payments to a PSC are subject to income tax and national insurance at source by the engaging entity "EE".

HMRC have undertaken a number of legal challenges to PSCs under the IR35 legislation but these did not prove particularly successful. Thus, in what many see as an attempt to circumvent the many hurdles in proving self employment, the law was changed such that any PSC working for a public sector EE with effect from April 2017 would be subject to deduction of tax at source.

As from 6 April 2020, every PSC providing services to a private sector EE falls into this system and responsibility for determining whether the IR35 rules apply passes to the EE. In this regard, a PSC falls into the review process if at least two of the following apply :

1. Gross sales less than £10.2 million per annum.
2. Balance sheet total less than £5.1 million.
3. Less than 50 employees.

Even if the EE considers that IR35 applies, ultimate responsibility for the tax stance remains with the PSC. The exemption limits suggest that almost every PSC, unless part of a large group, will require to be assessed. Where there is dubiety about whether the PSC is an employee rather than self-employed, the clear danger is that the EE will adopt a blanket approach such that all PSCs are caught.

HMRC have published a tool on their website in order to help determine if IR35 applies, but notwithstanding this, one would have to wonder why any large entity would risk paying a PSC gross when HMRC have made it quite clear that any loss of tax to the Treasury as a result of doing so, will fall upon the EE.

Whilst the Treasury have estimated that an additional £2.9 billion might be collected by 2024, this could well be overstated on the basis that the PSC is already a taxpaying entity i.e. some tax will be paid anyway, but significantly later from a Treasury cashflow perspective than if tax is deducted at source by the EE.

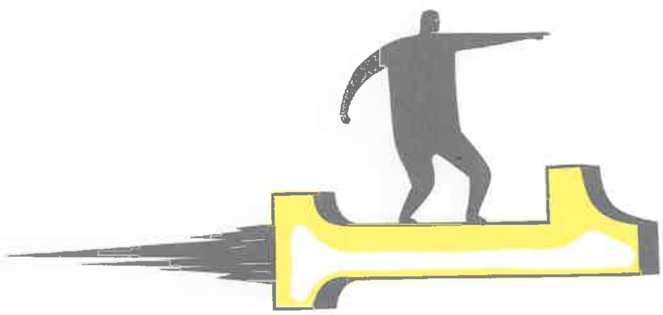
Is this the end of a PSC?

Much may depend upon any other uses of a PSC, or whether the PSC is able to convince the EE that IR35 does not apply. Certainly, if income tax and national insurance are to be deducted at source, one would query the benefit of paying accounting/tax compliance costs on an annual basis when the individual will be left in no better a position than if he/she was an employee. Meston Reid & Co has negotiated a unique deal for PSCs to access a specialist contract advisor if IR35 status is in doubt i.e. provide an expert view in the event of an HMRC enquiry.

Anecdotally, some anticipate that there could be more umbrella company structures and other "foolproof" ways launched which demonstrate that IR35 does not apply to a particular PSC. Others comment that an EE will simply pay more to a PSC in order to take account of the tax deductions. The over-arching question is why shouldn't an EE simply deduct tax and avoid any risk of HMRC pursuing them later for tax that they should have been deducted because the IR35 assessment was wrong?

Meston Reid & Co is witnessing an increase in the number of solvent liquidation enquiries with a view to individuals seeking to draw a line under PSC activity and, ideally, obtain a PAYE position before April 2020 arrives.

Further heightening the desire to act promptly is the concern that, whilst recent HMRC pronouncements indicate that they will not take a retrospective approach to IR35 status, they reserve the right to do so in cases where they may consider that there has been either fraudulent or deliberate behaviour.



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Many PSC balance sheets feature a director's overdrawn loan account which might reflect a need for a PSC to continue trading activities beyond April 2020 in terms of a requirement to recover such loan account. One aspect of a solvent liquidation process is the ability to set the loan against a capital distribution, thereby negating the need for a director to repay the full sum. Another reason why the option of a solvent liquidation can prove attractive.

If anyone is in doubt about the HMRC desire to collect as much tax as possible, one only has to look at challenges over the last five or six years to EBT and other tax planning schemes : a nightmare for the vast majority of taxpayers involved with them.

Unused childcare vouchers

It can often be the case that an employee finds that he/she has childcare vouchers that cannot be used because of a change of circumstances. Employers have a duty to make each employee aware of the value of the vouchers issued to them and any conditions regarding the expiry of such vouchers. However, experience suggests that an employer in financial difficulty is unlikely to have this issue at the forefront of thinking and, whilst an employee can ask for unused vouchers to be refunded (against which PAYE and NIC will be deducted if the employee is to make the refund), what happens if the employer is subject to formal insolvency proceedings?

The answer is that a claim from the individual will rank as an unsecured liability : meaning that the chances of payment tend to be slim. Anyone advising employees who remain in a childcare voucher scheme should encourage them to use the vouchers sooner rather than later.

Auto-enrolment and formal insolvency

As advisors will be aware, one's duties as an employer under the auto-enrolment scheme start on the date that the first member of staff commences work. Under auto-enrolment, employers must enrol staff aged between 22 and State pension age in a qualifying pension scheme if they earn at least £833 per month and of course, employees meeting such criteria must be enrolled even if the employer knows the employee does not want to be a member of the pension scheme.

Sometimes, particularly when cash is tight, this aspect is overlooked, but when a trustee, liquidator or administrator enters the scene, one of the first steps is to determine the auto-enrolment positon in order to help safeguard any pension contributions due on behalf of employees.

The Pension Regulator has the authority to issue a Pension Contribution Order against an employer and case law is awaited which will clarify if such request can become a personal liability on a director of a limited liability company e.g. if it can be shown that he or she knew, or ought to have known, that the auto-enrolment process should have been undertaken.

Protected trust deeds : as popular as ever

The accountant in bankruptcy "aib" published his 2018/19 report in September and commented that in each year since 2015/16, more protected trust deeds have been registered than awards of sequestration. There has been an increase from 4,437 protected trust deeds in 2014/15 to 7,915 in 2018/19. As at 31 March 2019 more than 26,000 protected trust deeds were active.

When an individual signs a trust deed, proposals are submitted to creditors in order that protection can be granted which, for most purposes means that the process will continue rather like a sequestration. The key features will be dealing with any assets that the debtor owns, particularly the house, and collecting a contribution from income over a four year period.

This may help to explain the preference for a trust deed process rather than sequestration.

GDPR

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Conclusion

This Update is provided for general interest purposes and does not purport to offer definitive advice. Please contact either Michael J M Reid (reidm@mestonreid.com) or Michelle Byrne (byrnem@mestonreid.com) if you wish to discuss anything raised herein.

Thank you for taking the time to read this Update and feel free to pass it to anyone who you think might be interested in reading it.

Meston Reid & Co