Dáil Éireann

An Coiste um Chuntais Phoiblí

An Chéad Tuarascáil Eatramhach ar Chaillteanas Cánacha Muiníneacha a éiríonn as mí-úsáid Dliteanais Theoranta

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Dáil Éireann

Committee of Public Accounts
First Interim Report on the Loss of Fiduciary Taxes arising from abuse of Limited Liability

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Chairman's Preface

This report examines the loss of Fiduciary Taxes arising from company insolvency and the steps that need to be taken to give greater protection to this tax base. As you will see from the contents of the report, some of this loss can be put down to wilful evasion of taxes by company directors who abuse the protection given to companies under limited liability.

I look forward to seeing the key recommendations of the Committee being incorporated into Company Law here as it is the view of the Committee that greater deterrents are needed in order to prevent this type of tax evasion. This issue was first raised by the Committee of Public Accounts in 2003 and a number of recommendations were made by previous Committees of Public Accounts to make changes to the law, however the recommendations ultimately were not accepted by Government. Given the wider concerns that were preventing changes being made, the Committee undertook a comprehensive review in 2009 of all the issue and its hearings are available on the Oireachtas website.

As part of the Committees review of this issue, we looked at what happens in other countries given that this type of tax evasion is not unique to Ireland and that review helped the Committee in coming to conclusions on what changes are needed here.

I want to thank the Members of the Committee, the staff of the Committee and the witnesses, including the Chairman and staff of the Revenue Commissioners and senior officials in the Department of Enterprise, Trade and Employment for their input into the deliberations that led to this report.

The Committee recommends this report to Dáil Éireann.

Bernard Allen T.D.
Chairman.

February 2010

Executive Summary

Fiduciary Taxes are those taxes that are collected by companies and employers from staff and suppliers and are held in trust before being paid over to the State at certain intervals, in accordance with tax law. The main Fiduciary Taxes are PAYE and PRSI that are deduced from employees and VAT which is collected on the sales of the company.

In the last ten years, the Revenue has had to write-off more than a billion euro, mainly from companies that became insolvent and could not meet their tax obligations. This figure is likely to rise significantly this year and next given the increased number of companies that are becoming insolvent. The problem that arises, from a tax collection perspective, is that some of this write-off can be attributed to wilful evasion of tax by company directors who are able to use the veil of limited liability to protect themselves from having to meet their legal obligations.

The Committee accepts that many companies become insolvent because of trading difficulties and only go into liquidation after valiant efforts are made by directors of the entity to save the company and maintain it as a going concern. Those directors who are involved in what is know as "honest failure" and those who engage with the Revenue fall outside of the target scope of this report. What the Committee are proposing is that a deterrent is put in company law which will prevent malfeasant behaviour especially those who use the protection of limited liability purely to avoid paying tax that they have collected from third parties. Many of these directors will re-open a business, normally in the same type of trade, under a different name and they become know as phoenix operators.

The Report outlines the steps that have been taken in recent years, especially through the Office of the Director of Corporate Enforcement to tackle malfeasant behaviour by directors and evidence given by the ODCE shows that over 900 directors have been restricted or disqualified by the High Court since 2003. The report also examines the effectiveness of the oversight checks undertaken by the Revenue which involves close scrutiny of those companies which are regarded as high risk, given that their directors were associated with other companies that left significant taxes unpaid.

The Committee as part of its review of this issue, took evidence from the company law division of the Department of Enterprise, Trade and Employment given that it was the reservations of that Department in the past which prevented amendments to the legislation that would make, in certain circumstances, company directors personally liable for unpaid Fiduciary Taxes. The primary concern of the Department is that any moves to make directors personally liable for the tax debts of a company could lead to early insolvency and it could inhibit entrepreneurial endeavour which is needed so that new companies can survive and give employment.

The Report, in Chapter Three, examines the approach taken in the USA, Australia and UK and, having regard to the concerns of the Department of Enterprise Trade and Employment and to the cash flow difficulties being experienced by many companies at present, the Committee is calling for an amendment to company law which will provide that company directors who wilfully try and evade the payment of Fiduciary Taxes, and who do not engage with the Revenue, can in certain circumstances

become personally liable for unpaid PRSI. The Committee is of the view that this is a fair measure that will provide a further deterrent against those directors contemplating the evasion of taxes.

In addition the Committee is calling for a tightening up of arrangements in the area of company incorporation. In particular the Committee is pointing to the need to ensure that those who are being appointed to positions of director should have their tax affairs in order in order before they can take up appointment as a director of a company that has the protection of limited liability.

Chapter One

Extent of Abuse

Background

Abuse of the privileges and protections granted to companies through the system of limited liability is not a new issue and company law has evolved in order to tighten up the scope to abuse. For instance, there are provisions in the company law code whereby the protection of limited liability can be removed and company directors and other principals in companies can be made personally liable in specific circumstances. This would arise for example where a court found that directors engaged in fraud or reckless trading, however, in general and quite correctly, companies legislation is designed to enhance corporate endeavour and encourage investment which includes offering protection to individuals who own and manage companies, mainly through the protection of limited liability.

From a public accountability perspective, the issue of abuse of limited liability was first raised by the Comptroller and Auditor General in his Annual Report in 2001 when he analysed the write-off of taxes by the Revenue Commissioners. His comments at the Committee meeting of 13th February, 2003 summarise succinctly the public accountability concerns: *"... initial scrutiny of the associated papers relating to some individuals and their businesses involved in the [tax] write-offs led us to believe that there may be a deliberate abuse of the tax system. It appears that some individuals had been playing ducks and drakes with Revenue by succeeding in continuing their business affairs through related companies without detection which at the same time benefiting from tax write-offs...."* These comments were highlighting the need to have greater control over what are termed phoenix operators.

The Committee of Public Accounts subsequently recommended to the Minister that the protection of limited liability should not apply in such situations and Revenue made proposals to the Department of Finance which would, in certain very limited circumstances, make principals of companies personally liable for the unpaid Fiduciary Taxes collected by their companies and held in trust for the State. Those attempts to change company law were ultimately not successful. The Committee of Public Accounts raised this issue again this year, having regard to the amount of taxes that are written-off annually and the likelihood that this sum will rise significantly with the economic downturn which will see more companies going into liquidation. The Committee decided to conduct a detailed examination of the issue, which culminated with a public hearing on 22nd October, 2009. A copy of the debate on this issue is available on www.oireachtas.ie

Fiduciary Tax

A good description of Fiduciary Taxes is contained in the Company Law Review Group Report of 2007. They are referred to in the following terms: "Trust" taxes such as PAYE, PRSI, RCT and VAT payable, which are collected by the company and transmitted to Revenue on behalf of workers and consumers, are never the insolvent companies property…"

As outlined, these Fiduciary Taxes can be considered separately to all other taxes since they represent identifiable sums collected or retained by businesses from third parties on the express understanding that these monies are payable to the Revenue Commissioners. The monies collected or retained are not the property of the collecting body but are held by them in trust for the State.

Phoenix Operators

Phoenix operators are principals and directors of companies whose activities involve the company in:-

1. failing and being unable to pay its debts and/or
2. acting in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts and
3. immediately following cessation, another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.

The victims of phoenix activity are the Revenue Commissioners, as they are the primary and often the only creditor, and the legitimate competitors of the phoenix company who are prejudiced by the resulting unfair competition. The real issue or problem with a phoenix company lays with the directors who fail to learn from previous mistakes and who repeat them with the same ruinous effect and it is for this reason that Revenue monitors such entities closely, as will be outlined in Chapter Three.

Fiduciary Tax written-off

Before examining the amount of the write-off, it is important to place the issue in context which can be done by examining the amount of tax that is collected annually. Table One below shows the amount of tax collected together with the amount outstanding at the end of March of the following year: The Committee heard evidence which indicates that the relative position of the Irish Revenue *vis a vis* their OECD counterparts is favourable when it comes to managing the tax debt and to collecting the amount charged on time.

Table One

Year	Charges raised in year	Charges uncollected by 31 March in following year	%
2008	€44,700m	€558m	1.2%
2007	€47,220m	€331m	0.7%
2006	€42,683m	€270m	0.6%
2005	€38,382m	€240m	0.6%
2004	€34,718m	€270m	0.8%

The figures outlined in Table One show the efficiency of Revenue in collecting the amount due, although the Committee expects that the performance in 2009 will have slipped given the economic downturn. It is also clear that the amount of tax collected by Revenue in 2009 has fallen to €33 billion, while the amount of Fiduciary Taxes that are written-off in 2009 continues the year on year trend of increases. In that regard Table Two below shows that, in the past ten years, more than a billion euro in Fiduciary Taxes has been written-off and the concern of the Committee on Revenues performance is that while the figures show efficiency in collection, difficulties arise when trying to collect taxes that fall into arrears.

Table Two

Year	Amount Written-Off €m
2000	78.2
2001	60.0
2002	148.3
2003	77.9
2004	147.0
2005	97.9
2006	100.2
2007	106.9
2008	115.6
2009	202.9

Approximately 80% of the figure for 2009 relates to companies that went into liquidation or ceased trading. The Committee accepts that it is Revenue policy to try and keep write-offs to a minimum. Businesses do run into trading difficulties and these companies become unviable. However the majority of businesses that cease trading or go into liquidation do so for entirely legitimate commercial reasons. This is notwithstanding the fact that monies that were collected by those businesses in trust were used as cash flow to pay wages and run the business as it sought to trade out of its difficulties.

There are also other direct costs to the State where companies go into liquidation or cease trading. For instance, staff being made redundant have entitlements to Statutory Redundancy and while the company/employer can claim a rebate of 60% of the cost of the redundancy from the Social Insurance Fund, the Department of Enterprise, Trade and Employment has to meet the full costs in cases where there is an inability to pay due to lack of funds or where directors have simply walked away from their obligations and refused to pay. With the increasing numbers being made redundant (up from 25,549 in 2007 to 77,001 in 2009) the Department had to make payments totalling €85.5 million last year in respect of insolvent companies and, while that sum is not written-off, the amount that can be reclaimed after liquidations is small. The Department has estimated that there is an outstanding debt of €78.7 million due to the Social Insurance Fund at the end of 2009 in respect of payments made on behalf of insolvent companies.

It is difficult therefore to put an estimate on the amount of the write-off that can be put down to wilful evasion. A proportion of those who engage in phoenix activity can be attributed as abuse, however these are only a subset of those that are a cause of concern to Revenue and to the Office of the Director of Corporate Enforcement. Evidence given to the Committee, by the Office of the Director of Corporate Enforcement, shows that there were concerns about the behaviour of directors of insolvent companies in about 15% of liquidations examined. This latter evidence may give a truer indication of the extent of the problem that needs to be addressed. The focus of the Committee's deliberations, as contained in this Report, therefore is on reducing the level of write-off by having measures in place that will act as a disincentive to directors who are contemplating tax evasion by abusing limited liability. Before examining options that will act as a deterrent, Chapter Two will examine the ways and means in place to police those who have or are suspected of having abused their positions as company directors or who, in their careers as directors have been involved in companies whose tax debts have had to be written-off.

Conclusion

The loss of Fiduciary Taxes through wilful evasion by companies, using the protection of limited liability continues to be an issue that needs to be addressed. The Committee accepts that the majority of companies which go into liquidation do so for purely trading reasons and that there is no malfeasance on the part of their directors. In addressing the issue of malfeasance, it is important that an unnecessary burden is not placed on those directors who act with probity and honesty and later chapters in this report will address these issues in greater detail.

Chapter Two

Measures to Prevent Abuse

Introduction

There are a number of programmes and company law provisions, some of which have developed significantly in recent years that seek to prevent the abuse of the protections provided under limited liability and to limit the loss of Fiduciary Taxes in such cases. This chapter examines the principle measures, namely:-

1. Revenue's commonality and phoenix programmes;
2. the work of the ODCE in dealing with errant directors;
3. the liquidation process.

The Committee is also aware of legal penalties that can apply under company law which would make directors personally liable for fraudulent or reckless trading; however these ultimate deterrents arise from court decisions where the evidential proof necessary to convict directors is very high.

Commonality and Phoenix Programmes

These two interrelated programmes have developed based on the risk assessment of certain companies and directors. Many individuals are involved as directors in more than one company and therefore, where a significant issue of non-compliance arises in one company, the others are also monitored closely to ensure ongoing compliance. Likewise, many companies are created from the ashes of previous entities as described in Chapter One and are referred to as phoenix companies. As will be highlighted later in this Report, not all phoenix entities can be deemed to be bad, however, where such new companies emerge, they are placed under close scrutiny by Revenue in order to ensure that they remain tax compliant.

Evidence given to the Committee shows that under the commonality programme, there are 1,235 companies under close scrutiny by Revenue at present. Many of these will be run in a tax compliant manner precisely because they have little scope to evade tax as a missed tax return will trigger an immediate response from Revenue. The reason these companies are placed on the commonality programme arises because of the need to ensure that companies linked by common directors where significant tax debts arise in any of these entities, are the subject of a dedicated focus in Revenue's tax collection enforcement and response. Revenue, at registration stage, conducts detailed analyses of all the directors involved in that newly registered company and whether any of these directors have a link to any other business where a significant tax compliance issue arose.

The phoenix monitoring programme is concerned with early identification and subsequent close monitoring of those entities that arise from the ashes of previous failed businesses which have left tax debts. Evidence given to the Committee shows that, in 2009, there were 536 companies in this monitoring programme. Once a company is tax compliant for two years it is taken out of this monitoring programme, although any regression would see the company reinstated into the programme. In

evidence, the Collector General of the Revenue Commission informed the Committee that, in 2009, 62% of these companies were assessed as being fully compliant. Those that are not compliant would, over time, cease operations, go into voluntary liquidation or be the subject of liquidation instigated by Revenue. Some directors who are in the phoenix programme will have action taken against them by the ODCE (see below) and evidence given to the Committee shows the following:

Table Three

Year	Number of directors restricted by the High Court	Number of directors restricted by the High Court and whose company was being monitored in the Phoenix programme at the time	%
2007	140	10	7%
2008	77	9	12%

The phoenix programme is a useful leaver in either correcting malfeasant behaviour or in forcing malfeasant directors out of business. Evidence given to the Committee by Revenue shows that the number of companies that are being placed in the programme is growing and it was also pointed out that the programme itself was resource intensive. Given the pressure that will arise from the need to devote more Revenue resources to the programme, the Committee welcomes the undertaking given by the Accounting Office to conduct a comprehensive review of the effectiveness of oversight checks on the emergence and operation of phoenix type companies. Given that a figure of less than €2 million of the write-off in 2008 came from companies in the phoenix programme, it would be useful if that review also examined the interactions between Revenue and the companies where there was a significant tax write-off. The purpose of this wider review would be to establish additional measures needed to be put in place in order to minimise the overall write-off.

Action by the Office of the Director of Corporate Enforcement

The ODCE, through its activities, acts as a significant deterrent to dishonest or irresponsible behaviour on the part of company directors. The ODCE has a memorandum of understanding with Revenue which allows the exchange of information, especially in relation to the manner in which directors of insolvent companies have discharged their responsibilities, particularly in relation to the payment of tax. Under company law, where dishonest or irresponsible behaviour is detected, the directors will face restriction or disqualification proceedings. Over 900 company directors have been restricted or disqualified by the High Court since 2003.

The ODCE reviews reports from liquidators in every insolvent liquidation and, essentially, operates a filtering system in which cases go forward to the courts to determine whether the directors of the insolvent companies should be sanctioned. While 85% of reviews indicate that liquidation arose from a genuine business failure, in 15 % of cases there was evidence of irresponsibility or dishonesty on the part of the directors.

Liquidation Process

Liquidators are required by law to take High Court Restriction proceedings against errant directors, unless the ODCE relieves them from doing so. In many cases, liquidators are supported by the Revenue Commissioners to pursue such court action as it is often the case that liquidators will not have sufficient funds available in the insolvent company to mount a court action. In certain cases Revenue will fund a liquidator to pursue such action even though there is no prospect of a return in terms of higher tax receipts. In 2007 there were 704 liquidations and of these 19 were at the instigation of Revenue. As was pointed out and accepted by the Committee, in the current trading environment, Revenue will only instigate liquidation as a last resort and will try and work with Companies who have a business plan that will enable them to trade out of their difficulties.

Clearly, placing a company in liquidation where a major tax default is uncovered is one way of limiting the tax write-off of insolvent companies. This is particularly the case given the priority status enjoyed by the Revenue Commission in terms of the distribution of liquidated assets. The problem in many cases is that, by the time companies either go or are put into liquidation, there are no assets left to redistribute. This fact is borne out by the returns from liquidations received by Revenue which show that in 2006 the amount recovered was just over €1 million, in 2007 it was just €766,000 and in 2008 it was slightly in excess of €2 million, of which €929,000 related to one specific case. When pressed by the Committee on the poor return from liquidators, the Collector General pointed out that the returns achieved materialised primarily because of the priority status enjoyed by Revenue and the returns would have been less without this status.

Conclusion

The examination of the issue of abuse of limited liability shows that strong measures have been put in place in recent years to combat abuse. In particular the restriction and disqualification of directors offer a powerful deterrent to malfeasant behaviour. Linked with this, the higher level of scrutiny under the commonality and phoenix programmes put greater pressure on directors, with a previous track record of managing companies that were in default, to remain tax compliant. However, having regard to the evidence which indicates about 40% of companies in the phoenix programme continue to be non-compliant and that, in about 15% of liquidations, there are issues of concern in relation to the behaviour of directors, the Committee agreed that, in addition to reviewing the effectiveness of the phoenix monitoring programme, it was necessary to examine what further deterrents could be built into the system and the risks associated with any measures that would place restrictions on the use of limited liability. These issues will be examined in Chapter Four. In Chapter Three the Committee outlines the principle findings of its examination of the measures that are put in place in three other countries in order to give greater protection to Fiduciary Taxes.

Chapter Three

Measures that give greater protection to Fiduciary Taxes

Introduction

Legislation providing for the recovery of certain unpaid tax liabilities from company directors already exists in the United States of America, the United Kingdom and Australia. The Committee commissioned Frank Mitchell BL to provide a short research paper on measures introduced elsewhere to prevent abuse of limited liability and a summary of his main findings is outlined below. Chapter Four will examine the risks that arise with any proposal to interfere with the provisions of limited liability.

United States of America

The thrust of the relevant provisions in the USA are set out Internal Revenue Code which provides as follows:

> "*Any person required to collect, truthfully account for, and pay over any tax imposed by this title who wilfully fails to collect such tax, or truthfully account for and pay over such tax, or wilfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.*"

This provision does not focus on company directors but targets, rather, *"any person required to collect, truthfully account for, and pay over any tax imposed by this title…"*. The taxes to which this provision relates are federal income taxes and social security which have been deducted from employees' wages and are therefore akin to PAYE and PRSI in this country. It is noteworthy that the failure to pay over the taxes when due must have been "wilful". It is also interesting to note that the foregoing liability is imposed in the context of a specific provision in the US Tax Code to the effect that taxes of this nature which are collected by employers are *"to be held to be a special fund in trust for the United States."* This status, has led to the Judicial comment that:

> *"Such funds, which are remitted to the government on a quarterly basis, are for the exclusive use of the United States and are not available to cover operational or business expenses."*

In general terms, persons will be considered a "responsible person" where they actively participates in the management of the company and have "effective power to pay the taxes owed and will have acted "wilfully" where they had reason to know that the taxes were not being paid and failed to exercise their authority to ensure payment.

The US legislation, therefore, specifically designates certain taxes (equivalent to PAYE and PRSI in this jurisdiction) to be held on trust for the State. Indeed, they must be kept in a separate bank account and are not to be used for the purposes of meeting the business's running expenses.

Where the people responsible for the fund wilfully fail to account for the proceeds they will be held liable for their actions by way of penalty.

United Kingdom

In the UK, provision is made for personal liability of company officers only in respect of National Insurance Contributions (NIC) – the UK equivalent of PRSI – and to this extent is quite limited in scope.

The relevant legislation is of broad effect in this narrow field of application. It provides, simply, that where a company has failed to pay its contributions by the due date, Inland Revenue may issue a Personal Liability Notice where:-

1. the failure appears to the Inland Revenue to be attributable to fraud or neglect on the part of one or more individuals; and

2. the individuals were officers of the company at the time of the fraud or neglect.

Once again, the directors are not made personally liable for the company's taxes but rather have a penalty of an equivalent amount levied upon them. The company remains liable for the taxes and the directors for the penalty ascribed to them, though payment of one will reduce the amount outstanding in respect of the other. The power provided by legislation is broad-ranging in that the Inland Revenue need only be satisfied that:-

1. there has been an underpayment;

2. this underpayment was due to fraud or neglect on the part of an officer of the company (including *de facto* directors and shadow directors). In order to counteract the scope of the statutory power provided to it, Inland Revenue issued guidance on the manner which it would be exercised. It is instructive to consider one or two passages from this guidance;

> *"In law, a Personal Liability Notice may be issued whenever contributions are unpaid because of the neglect of a culpable officer. Clearly any failure to pay on time can constitute "neglect" as a taxpayer who knows of an obligation - the need to pay National Insurance Contributions by a certain date - and fails to fulfil that obligation is negligent.*

However, in practice, a Personal Liability Notice will only be issued in the most serious cases. What we are looking at is persistent failure to pay against a background of other payments being made on time or, for instance, the continued drawing of a director's salary. And we will be focusing on cases where the culpable officer has been involved with other companies which have had persistent or substantial failures to pay.

Before consideration is given as to whether a Personal Liability Notice should be issued the full facts behind the company's failure to pay the "contributions" due will be inquired into. We will aim to identify the officers whose negligence or fraud has led to the non-payment and the extent of the responsibility of each culpable officer."

The UK model therefore involves the prospect of liability for NIC payments only; is broad in its scope but limited in its application.

Australia

In 1993 new legislation was introduced into the Income Tax Code governing the recovery of certain un-remitted taxes of a fiduciary nature which had been collected on behalf of the Revenue Authorities. In so far as it relates to the collection and payment of taxes by companies, the legislation imposes a penalty regime targeted at company directors.

The legislation imposes a positive duty upon all company directors to cause the company to either:-

1. remit the amounts of tax payable by the due date;
2. enter into a payment arrangement with the Revenue Authorities regarding payment of the tax;
3. appoint an administrator to the company (analogous to examinership in Irish company law); or
4. appoint a liquidator to the company.

Where a company has not complied with the foregoing then:

"each person who was a director of the company at any time during the period beginning on the first deduction day and ending on the due date is liable to pay to the Commissioner, by way of penalty, an amount equal to the unpaid amount of the company's liability"

This creates a *prima facie* liability on each director for a penalty equivalent to the unpaid tax and underscores a director's duties to ensure that all relevant taxes are

collected and remitted in a timely manner. It is not, however, a provision which applies in a blanket fashion since, in order to recover the penalty from a director the Revenue Commissioners must send the director(s) a notice which sets out details of the company's unpaid taxes and the consequences of failing to take any one of the prescribed measures.

Although the amount payable by the director is a penalty equivalent to the outstanding tax, and not the tax itself, the penalty paid is set off against the company's tax liability and the director then has a right to recover from the company (or other directors) the money paid, as if it were paid by him under a guarantee. In this sense the "limited liability" of the shareholders is unaffected as it is the company's officers (not its shareholders) who are targeted and the liability is a separate penalty imposed on the responsible officers not the imposition of liability for the company's debts.

A director who would otherwise be liable for a penalty may be exonerated if he can show that "because of illness or for some other good reason" he did not take part in the management of the company at the relevant time or he took "all reasonable steps to ensure that the directors complied with [their statutory obligations]."

In 2003 the New South Wales Court of Appeal held that the "Directors" to whom these provisions apply was held to include both shadow directors and *de-facto* directors.

In this jurisdiction a "shadow director" is defined by the Companies Acts however the concepts of shadow and *de-facto* directors are best explained by the following passage:

> *"A de facto director is one who claims to act and purports to act as a director although not validly appointed as such. A shadow director by contrast does not claim or purport to act as a director. On the contrary claims not to be a director. He lurks in the shadows, sheltering behind others who he claims, are the only directors of the company to the exclusion of himself."*

The Australian model, unlike that in the USA, allows companies to make full use of the Fiduciary Taxes collected up until the date of payment. It is only following the receipt of a relevant notice, that the director(s) in question may face a penalty. This penalty may be avoided by either (a) paying the tax, (b) entering into a payment arrangement with the Revenue Authorities, (c) appointing an administrator to the company or (d) appointing a liquidator to the company. It is only where a director takes none of these steps that he will be held liable for a penalty equal to the outstanding tax.

Conclusion

Having reviewed provisions in three other States which made directors of companies personally liable for unpaid Fiduciary Taxes, the Committee is satisfied that there is further scope available to the State to protect its Fiduciary Taxes. However, before making any recommendations to this end, it is necessary to examine the risks associated with interfering with limited liability and this is the subject of Chapter Four.

Chapter Four

Risks associated with making Directors personally liable

Introduction

The Committee sees a need to strengthen provisions which would deter malfeasant directors and would increase the likelihood that Fiduciary Taxes would not be written-off. The central issue to be considered is whether it is possible to lift the veil of corporate personality without incurring risks that could defeat the original purpose of the deterrent. In that regard, the Committee has to take account of the concerns of the Department of Enterprise, Trade and Employment on this matter in particular arising from the proposals made by Revenue to give personal liability to directors in certain defined cases. This chapter analyses the risks associated placing limits on the concept of corporate personality.

The underlying importance of having limited liability

Limited liability encourages investment by allowing a member to participate in a business and profit if it does well while limiting the loss of a member if it fails. In the latter case of company failure, the loss to the member or shareholder is limited to the amount of the shareholding, or in the case of a company limited by guarantee, the liability extends only to the amount guaranteed. The Committee accepts that while there does exist provisions in company law which place restrictions on limited liability (in cases for instance where a court finds that a principal in a company engaged in reckless trading), there is a basic requirement that any further restrictions that dilute the protections of limited liability should only be introduced in a manner that would not act to discourage any person from establishing a business. That requirement should also apply to those people who have already failed in business.

The danger of early liquidation

One of the concerns indicated in evidence to the Committee is that if an element of personal liability were to become attached to company directors that, in circumstances where that company experienced trading difficulties, there could be an incentive for the directors to liquidate the company rather than incur any personal liabilities. In today's trading environment, the Committee would view such consequences as highly undesirable. Many companies are experiencing trading difficulties and this has led to many entering into arrangements with Revenue whereby tax liabilities are being paid by instalments. Clearly the vast majority of company directors are working hard to continue to trade and have cut costs to ensure survival in the hope that the company will trade out of its difficulties once growth returns to their business sector. These companies are approaching Revenue in relation to the tax bills that are falling due and, quite correctly, Revenue, where there is a viable business plan, are facilitating them by agreeing phased payments of tax. Given such situations, the Committee is conscious of the need to ensure that as many companies as possible survive this economic recession as they will emerge leaner and stronger companies in the future and therefore any proposal to make directors of those companies personally responsible for any of the tax debts of those companies needs to be framed so as to apply in very limited circumstances.

Interference with cash flow

In order to avoid any likelihood of personal liability being attached to directors, companies may be forced to set aside the funds collected on trust from employees and suppliers. However, in addition to the trading difficulties being experienced by companies, as outlined, many companies are also experiencing cash flow difficulties as overdraft facilities and bank loans are being curtailed. The majority of firms therefore will not have the luxury of retaining Fiduciary Taxes in a separate pot to be paid over to Revenue. The Committee is aware that many businesses fail not because they are not profitable but because of cash flow difficulties and therefore it does not propose to recommend any proposal that would limit the use of Fiduciary Taxes given the additional cost burden it would impose on already cash strapped businesses.

Deterrent to Foreign Direct Investment

Evidence was submitted to the Committee to the effect that any proposal to dilute limited liability could result in making Ireland less attractive to foreign direct investment. In general foreign direct investment tends to come from larger type entities and it is unlikely that these would ever be identified as coming within the phoenix monitoring programme. In addition, much of Ireland's foreign direct investment comes from the USA and as was seen in Chapter Three, their regime and their treatment of Fiduciary Taxes is far more stringent than is the case here. The Committee is therefore of the view that any proposal to make directors personally liable for unpaid Fiduciary Taxes is unlikely to have a negative impact on foreign direct investment.

Conclusion

Any proposal that would limit the application of limited liability would have to be a measured one which would not seek to impose a duty on all directors and only on those directors who had track record of non-compliance. A broad application of measures could have implications by increasing the incidence of liquidation, which is precisely what the Committee, and indeed Revenue, wants to avoid. What the Committee primarily has in mind is that the limited circumstances in which limited liability protection could be lost would act a deterrent to directors who contemplate wilfully avoiding the remittance of Fiduciary Taxes. Chapter Five will examine the options available and will make certain recommendations arising from the evidence made available to the Committee.

Chapter Five

Options and Recommendations

Introduction

The Committee accepts that there is a need to introduce further measures in order to reduce the amount of Fiduciary Taxes that are lost due to the malfeasant behaviour of directors. Such measures should not place a burden on the vast majority of directors who act with probity in dealing with the tax affairs of their companies. As outlined in evidence before the Committee, what needs to be introduced is a deterrent, which will make directors aware of the negative consequences which could arise for them in the future if they wilfully evade paying the taxes that are due. The measures being proposed are therefore not a cure, but rather a deterrent against future malfeasant behaviour.

Potential for lowering the write-off of Fiduciary Taxes.

The Committee accepts that the level of Fiduciary Tax that is written-off is a marginal sum when viewed against the overall tax take. In addition, evidence given by the Collector General shows that of the €115 million that was written-off in 2008, less than €2 million could be attributed to companies that were in the phoenix monitoring programme. However this latter figure may understate the true cost to the State as phoenix operators form a sub-set of those who are likely to abuse the privileges granted by limited liability. In gauging the true extent of the costs involved, the Committee agreed that account needed to be taken of the following:-

- 38% of the 536 companies that are in the phoenix monitoring programme this year have tax compliance problems;
- of the 1235 companies that are monitored in the commonality programme by Revenue, approximately 50% have tax compliance problems;
- the ODCE, based on its analysis of liquidations, found evidence of irregular or malfeasant behaviour by directors in 15% of cases;
- the amount being realised from liquidations are very low, which suggest that the preferential status of Revenue may not be working as intended;
- there are other costs arising to the State where companies go into liquidation including the unpaid PRSI Contributions which must be credited by the State to the Social Insurance Fund and statutory redundancy payments both of which must be met by the State. As outlined in Chapter One, there is at present a debt of €78.7 million owed to the Social Insurance Fund, because of the failure by insolvent companies to meet their Statutory Redundancy obligations.

The Committee accepts that much has been done to reduce the scope for malfeasant behaviour on the part of directors, especially through the work of the ODCE and through Revenue monitoring programmes, however it is of the view that further deterrents would help in preventing malfeasant behaviour prior to liquidations and would also provide greater protection against phoenix type operators.

Lessons from other Jurisdictions

The Committee, having reviewed the additional safeguards put in place in three other jurisdictions has concluded as follows:-

1. The system in the USA, while providing the greatest degree of protection to Fiduciary Taxes, would impact negatively on corporate activity given that it could cause severe cash flow difficulties and for that reason, the Committee will not recommend this model.
2. The Australian model places a penalty on directors if they have not made arrangements with Revenue to pay the taxes or if they have not liquidated the company. In the evidence given to the Committee, it is clear that in Ireland, many companies are approaching Revenue about their outstanding tax bills and are entering into instalment payment arrangements. The Committee is concerned that the Australian system could lead to early liquidations and in the absence of strong evidence which supports the effectiveness of such measures, it feels unable to make a recommendation supporting the introduction of such measures here.
3. In the UK, provision is made for personal liability of company officers only in respect of National Insurance Contributions – the UK equivalent of PRSI. It only applies where there is persistent failure to pay and where the company director has a track record in not paying over the amount due to the State. The Revenue Commissioners are familiar with how the UK system works and are of the view that a similar provision would work here. In that regard the UK provision gives a strong power to Revenue which is used very sparingly. The fact that the deterrent exists rather than its use may be an indication of its effectiveness. Special treatment of PRSI already in Irish legislation under Section 16 of the Social Welfare (Consolidation) Act 1993 which provides that the PRSI contributions are not included in the assets of a company and do not form part of the funds available for distribution in the liquidation process. Clearly the UK legislative provisions could be deemed a further step in protecting PRSI and the Committee is satisfied that such a measure here would be worthwhile.

Other measures to combat Phoenix type behaviour

The Committee understands that phoenix type behaviour is not unique to Ireland and that wilful tax evasion on the part of directors, no more than ordinary tax payers, will always form some feature of tax administration. In addition to bringing an additional element of personal liability for PRSI contributions, the Committee also examined other deterrents and will recommend specific changes in respect of tax clearance or

further examination by the Company Law Review Group in certain areas highlighted hereunder.

Tax Clearance

The Committee understands the need to facilitate the incorporation and registration of companies in an easy and speedy manner. However it is of the view that the system could be tightened up in order to ensure that those establishing companies have a track record of good behaviour. In that regard, the Committee notes the upcoming change which will require persons incorporating a company to provide PPS numbers and is surprised that this measure was not a feature of company law before now. The Committee accepts that a new entity will not have a previous tax record and therefore it has be given a tax trading number, however the principals behind any new company should be required to provide tax clearance certificates as part of the incorporation process and that provision should also apply to new directors appointed to existing companies. This provision could inhibit the ambitions of directors with a track record of malfeasant behaviour from establishing new companies, having walked away from a previous entity which left a tax debt and it could act as a deterrent to existing directors contemplating evading tax under the protection of limited liability. The Committee recommends that an amendment be made to company law requiring principals of companies being incorporated to have their tax affairs in order, as far as Revenue is concerned, before they are allowed to be registered as company directors.

Level of Capitalisation

The Committee examined whether a bonding mechanism could be introduced for companies and accepts that bonding may not be an appropriate mechanism especially as it would tie up too much capital in a company. However, it may be appropriate to examine the level of capitalisation that is required of new companies establishing here. The Committee understands that some jurisdictions impose moderate initial capital levels and, given the privileges that are conferred on companies through the availability of limited liability status, it may be necessary to impose a minimum level of capitalisation here. What the Committee has in mind is a figure of between €5,000 and €10,000; however, such a measure would have to be examined by the Company Law Review Group to assess the full impact and the Committee recommends this.

Recommendations of the Committee

The Committee recommends as follows:-

1. That the legislative provision of the UK authorities which could make directors, with a track record of non-compliance for tax purposes, personally liable for PRSI contributions collected by the company be introduced into Irish law as a deterrent to continued malfeasant behaviour of directors.

2. That the review of the phoenix monitoring programme be widened to examine the interactions between Revenue and those companies where there was a significant write-off of tax with a view to establishing whether further measures are necessary in order to minimise the level of write-off.

3. That company law provide that company directors are required to have their tax affairs in order when incorporating a new company or on being appointed to an existing company.
4. That the Company Law Review Group examine whether the current levels of capitalisation required when incorporating a limited company in Ireland could be increased to a moderate level.

Appendix A

Orders of Reference of the Committee of Public Accounts

158. (1) There shall stand established, following the reassembly of the Dáil subsequent to a General Election, a Standing Committee, to be known as the Committee of Public Accounts, to examine and report to the Dáil upon—

(*a*) the accounts showing the appropriation of the sums granted by the Dáil to meet the public expenditure and such other accounts as they see fit (not being accounts of persons included in the Second Schedule of the Comptroller and Auditor General (Amendment) Act, 1993) which are audited by the Comptroller and Auditor General and presented to the Dáil, together with any reports by the Comptroller and Auditor General thereon:

Provided that in relation to accounts other than Appropriation Accounts, only accounts for a financial year beginning not earlier than 1 January, 1994, shall be examined by the Committee;

(*b*) the Comptroller and Auditor General's reports on his or her examinations of economy, efficiency, effectiveness evaluation systems, procedures and practices; and

(*c*) other reports carried out by the Comptroller and Auditor General under the Act.

(2) The Committee may suggest alterations and improvements in the form of the Estimates submitted to the Dáil.

(3) The Committee may proceed with its examination of an account or a report of the Comptroller and Auditor General at any time after that account or report is presented to Dáil Éireann.

(4) The Committee shall have the following powers:

(*a*) power to send for persons, papers and records as defined in Standing Order 85;

(*b*) power to take oral and written evidence as defined in Standing Order 83(1);

(*c*) power to appoint sub-Committees as defined in Standing Order 83(3);

(*d*) power to engage consultants as defined in Standing Order 83(8); and

(*e*) power to travel as defined in Standing Order 83(9).

(5) Every report which the Committee proposes to make shall, on adoption by the Committee, be laid before the Dáil forthwith whereupon the Committee shall be empowered to print and publish such report together with such related documents as it thinks fit.

(6) The Committee shall present an annual progress report to Dáil Éireann on its activities and plans.

(7) The Committee shall refrain from—

(*a*) enquiring into in public session, or publishing, confidential information regarding the activities and plans of a Government Department or office, or of a body which is subject to audit, examination or inspection by the Comptroller and Auditor General, if so requested either by a member of the Government, or the body concerned; and

(*b*) enquiring into the merits of a policy or policies of the Government or a member of the Government or the merits of the objectives of such policies.

(8) The Committee may, without prejudice to the independence of the Comptroller and Auditor General in determining the work to be carried out by his or her Office or the manner in which it is carried out, in private communication, make such suggestions to the Comptroller and Auditor General regarding that work as it sees fit.

(9) The Committee shall consist of twelve members, none of whom shall be a member of the Government or a Minister of State, and four of whom shall constitute a quorum. The Committee and any sub-Committee which it may appoint shall be constituted so as to be impartially representative of the Dáil.

Committee of Public Accounts
30th Dáil

Allen, Bernard (FG) (Chairman)

Broughan, Thomas (Lab)

Clune, Deirdre (FG)

Collins, Niall (FF)

Fleming, Seán (FF)

Kenneally, Brendan (FF)

McCormack, Padraic (FG)

McGrath, Michael (FF)

O'Brien, Darragh (FF) (Vice-Chairman)

O'Keeffe, Edward (FF)

O'Keeffe, Jim (FG)

Shortall, Róisín (Lab)