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## HMRC and the Covid-19 furlough scheme: New civil enforcement powers emerge, but prosecutions remain in prospect

In response to the Covid-19 pandemic the UK Government has committed billions of pounds to preserving livelihoods and jobs via the Self-Employment Income Support Scheme ("SEISS") and the Coronavirus Job Retention Scheme ("CJRS") (together the "**Scheme**").

At the start of April 2020, Jim Harra, the Chief Executive of HM Revenue and Customs ("**HMRC**"), told the Treasury Select Committee that HMRC expected the Scheme to be a target for fraud:

*"We are going to be paying out a vast sum of money in a rapid period of time. Any scheme like this is a target for organised crime. Any scheme that pays out I'm afraid attracts criminals that want to defraud it and people that are genuinely entitled to it who inflate their claims."*

To date, there is some evidence that Mr Harra's concerns were well-founded. As of the end of May 2020, HMRC had received 1,868 reports of alleged fraud on the Scheme via its digital reporting service. This is more than double the number of reports it received as of 12 May (795).

On 29 May 2020 draft legislation was published, which affords HMRC compliance and enforcement powers in order to ensure that the Scheme is protected from fraudulent claims.

When enacted, the new legislation will equip HMRC with powers to recover payments from anyone who has received a payment under the Scheme to which they were not fully entitled, or which was not used to pay employee costs, and to charge a penalty where HMRC can demonstrate that an applicant has behaved deliberately. In certain circumstances, individual officers of a company can be held liable for repayments.

Additionally, HMRC has extensive powers and resources to investigate revenue offences with a

view to criminal prosecution. Given the substantial public interest in punishing and deterring criminality which exploits the Covid-19 pandemic, and in safeguarding public funds during a period of economic distress, it is to be expected that HMRC will use its criminal powers to investigate and, where appropriate, prosecute cases of suspected fraud on the Scheme.

This briefing note considers the potential for fraud on the Scheme and HMRC's likely response to such fraud. As will be seen, it may not only be the most sophisticated frauds, and "*organised crime*" envisaged by Mr Harra, which are subject to criminal investigation and prosecution by HMRC.

### The Job Retention (Furlough) Scheme

In the first 30 minutes of its opening on 20 April 2020, 67,000 claims were made by employers under the Scheme. By 12 May 2020, claims had been made in respect of 7.5 million employees. On the same date, the total amount claimed under the Scheme reportedly reached £10.1 billion. HMRC has reported that it takes only six business days to verify and make payment in respect of each claim.

The Scheme was initially intended to end on 30 June 2020. On 12 May 2020, the Chancellor of the Exchequer announced that the Scheme was to be extended to October 2020. The mechanics of the Scheme, as operational from April to July 2020, can be summarised as follows:

- Under the Scheme, the UK government will cover up to 80% of an employee's wage, to a monthly cap of £2,500. Employers will also be paid the associated Employer National Insurance and pension contributions;
- Employers can claim for wages dating back to 1 March 2020;
- In general, all employers (including individuals) can claim under the Scheme, provided that the

employees put on the Scheme (i.e. those who have been "furloughed") have been on the employer's Pay As You Earn payroll on or before 19 March 2020; and

- Up until 31 July 2020, furloughed employees are not allowed to generate income or provide services for the employer or the employer's linked / associated companies. Each furlough must be for a minimum of three weeks.

Importantly, HMRC guidance states that companies currently in administration can also claim under the Scheme, on the condition that there is a "*reasonable likelihood of rehiring the workers*."

The High Court has confirmed that administrators have access to the Scheme, whether for companies currently in administration seeking to put employees on the Scheme (*Re Carluccios Limited* [2020] EWHC 886 (Ch)), or where a company which has already put its employees on the Scheme subsequently enters administration (*Re Debenhams Retail Ltd* [2020] EWHC 921 (Ch)). In *Re Carluccios*, the High Court also clarified that the administrator's aim to sell the company under administration (and hence transferring the employees to the new owner) fulfils the "*reasonable likelihood of rehiring*" requirement, in line with HMRC guidance.

### Potential for fraud on the Scheme

In his remarks to the Treasury Select Committee in April 2020, Mr Harra appeared to envision two distinct types of fraud, to which the Scheme may be subject:

- **"Organised Crime"**: Here, Mr Harra may have in mind the creation of sham companies, and / or claims for support made in respect of non-existent employees.
- **"People that are genuinely entitled to [Scheme support] who inflate their claims"**: Whilst there will be a large measure of overlap with frauds perpetrated by organised criminals, here Mr Harra appears to envision frauds committed by individuals or companies that have a genuine entitlement to Scheme support, but claim more than that to which they are properly entitled.

Beyond these examples given by Mr Harra, there appear to be several other species of fraud, and associated revenue offences, which might be committed by those seeking to exploit the Scheme, and which may be investigated using criminal powers by HMRC. These include:

- **"Working" employees**: whereby employees continue to provide, or resume providing, services to the employer, despite the employer having

made (or continued) a claim on the Scheme in respect of those employees.

- **Use of Scheme funds for an improper purpose**: whereby a claim is made on the Scheme, and funds are received by the applicant, but those funds are not used to pay employee costs, PAYE, NICs and / or make pension contributions.
- **Insolvency**: absent further guidance from HMRC or the Courts, there is likely to be contention around whether an administrator was correct in considering it "*reasonably likely*" that the employees will be rehired, and making a claim on the Scheme on that basis.
- **Submission of false statements or documents**: whereby an individual or company makes a statement, or submits a document to HMRC which is "*untrue in a material particular*", for example, the submission of falsified data as regards employees' salaries, or eligibility to be the subject of a claim on the Scheme.

### HMRC's response to suspected frauds: prosecutions in prospect

HMRC's criminal investigations policy states that:

*"It's HMRC's policy to deal with fraud by use of the cost effective civil fraud investigation procedures under Code of Practice 9 wherever appropriate. Criminal investigation will be reserved for cases where HMRC needs to send a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate."*

Under COP 9 a person (termed the "**recipient**" of COP 9) suspected of tax fraud is given the opportunity to, "*make a complete and accurate disclosure of all their deliberate and non-deliberate conduct that has led to irregularities in their tax affairs*". COP9 provides that:

*"The term 'deliberate conduct' means that the recipient knew that an entry or entries included in a tax return and/or accounts were wrong, but the recipient submitted it/them anyway, or that the recipient knew that a liability to tax existed but chose not to tell HMRC at the right time."*

COP 9 provides for the recipient being afforded the opportunity to avoid prosecution by entering into the Contractual Disclosure Facility, thereby making a full disclosure as to all conduct which has led to tax irregularities, and paying a civil penalty, of up to 200% of the relevant tax loss.

### New Scheme-specific powers

The new legislative provisions, published in draft on 29 May, will provide HMRC with compliance and

enforcement powers in order to ensure that the Scheme is protected from fraudulent claims.

HMRC will be able to use its information and inspection powers to check a claim on the Scheme. HMRC will also have the power to recover payments from anyone who has received a payment under the Scheme to which they are not fully entitled or anyone who has not used a payment under the Scheme to pay employee costs. There is also provision for HMRC to impose a penalty, where HMRC can demonstrate that an applicant has behaved "*deliberately*".

The new provisions will also give HMRC powers to make an officer of an insolvent company jointly and severally liable for the Income Tax charge raised in relation to any Scheme payment to which the company was not entitled or any Scheme payment which was never intended to be used to pay employee costs.

### Criminal prosecution

In cases of tax fraud which are more complex and / or egregious than the submission of a false tax return, and where there is clear evidence of dishonesty, HMRC has historically used, and continues to use, criminal powers to investigate and prosecute where it suspects that one or more revenue offences have been committed.

In the specific case of frauds on the Scheme, there are a number of other factors which suggest that HMRC will resort to criminal, as opposed to civil, investigatory powers and pursue criminal prosecutions:

- The clear public interest in punishing and deterring criminality which exploits the Covid-19 pandemic, and in safeguarding public funds in a period of economic distress;
- Crown Prosecution Service ("**CPS**") guidance on charging decisions during the Covid-19 pandemic indicates that, whilst most "*serious fraud*" is to be treated as "*lower priority*" by prosecutors during the pandemic, "*Covid-19 related fraud*" is to be afforded the highest degree of priority ("*Immediate*" priority);
- Historically, HMRC has deployed criminal powers where individuals and corporate entities have exploited government schemes in an organised and sophisticated manner. At Stephenson Harwood, we have acted for individuals accused of revenue offences arising out of claims made on government schemes offering tax relief on Gift Aid donations, Carbon Credits and investments in the UK film industry. It would be surprising if frauds

on the Scheme were treated differently or more leniently;

- For the majority of revenue offences, such as the common law offence of cheating the public revenue, HMRC is required to prove dishonesty on the part of the accused. In April 2020, in giving judgment in *R v Barton* [2020] EWCA Crim 575, the Court of Appeal confirmed that the test for dishonesty in criminal proceedings was that set out in the Supreme Court case of *Ivey v Genting* [2017] UKSC 67. The CPS has described the *Ivey* test as more "*straightforward*". Assuming this perception of the new test is shared by HMRC, it may encourage the pursuit of revenue prosecutions for dishonesty offences which may not have been pursued under the old law (*R v Ghosh* [1982] QB 1053);
- Even without evidence of dishonesty, HMRC is able to prosecute individuals and companies for the offence of making a statement (or submitting a document) which is "*untrue in any material particular*", where such a statement is made (or document submitted), "*knowingly or recklessly*". It may therefore conceivably be the case that those who *recklessly* make untrue statements to HMRC, in pursuance of a claim on the Scheme, find themselves at risk of prosecution;
- Over the past decade, successive governments have afforded HMRC ever-greater resources to address tax evasion. The Chancellor has indicated in the 2020 Budget that the UK government will be investing £280 million across 2020-2021 to improve HMRC's tax compliance capabilities, and will seek to employ 1,300 more staff at HMRC. This is in addition to the approximately 4,500 staff currently employed at HMRC's Fraud Investigation Services unit, which is responsible for investigating and prosecuting tax fraud with the assistance of the Risk and Intelligence Service unit;
- HMRC has at its disposal a vast array of criminal powers, including the ability to issue Production Orders, apply to Court for warrants and conduct searches ("**dawn raids**") and make arrests. Not only are these powers available to HMRC, it has vast experience in utilising them. Information obtained from HMRC through Freedom of Information requests show that HMRC conducted 495 dawn raids across the 2018 – 2019 tax year. Additionally, HMRC's investigative capacity is such that the Financial Conduct Authority ("**FCA**") recently (as of 1 May 2020) entered into a Collaboration Agreement with HMRC, to provide single point of contact services under section 79(3) of the Investigatory Powers Act 2016; and

- HMRC is an effective investigator and has been very successful as a prosecutor. In 2018/19 HMRC prosecuted 749 individuals, securing 648 convictions, representing a 86.5% conviction rate. Remarkably, this can be considered "low" in the history of HMRC prosecutions – previous conviction rates include 90.9% (2017 – 2018), 90.8% (2016 – 2017) and 91.7% (2015 – 2016).

## Conclusion

HMRC has a range of powers which it is able to deploy to detect and take action against Scheme fraud, the demonstrated ability to prosecute tax offences successfully and the budget with which to do so. Whilst the most sophisticated, organised and high-value frauds will be very likely to be the subject of criminal investigation, more difficult decisions will have to be made in what might be termed "marginal cases", for example, where companies have recklessly (as opposed to dishonestly) exaggerated claims on the Scheme, or where the exercise of judgment in pursuit of claims on the Scheme by administrators has proven erroneous. In such cases, early proactive and effective representations to HMRC may make the difference between a civil resolution (for example, a penalty under the new legislative provisions) and criminal prosecution.

Stephenson Harwood has extensive experience in advising and representing individuals and companies subject to civil and criminal investigation by HMRC. Should you have any questions about this area please do not hesitate to contact us.

## Contact us



**Tony Woodcock**

Partner

T: +44 20 7809 2349

E: [tony.woodcock@shlegal.com](mailto:tony.woodcock@shlegal.com)



**Alan Ward**

Senior associate

T: +44 20 7809 2295

E: [alan.ward@shlegal.com](mailto:alan.ward@shlegal.com)



**Justin McClelland**

Partner

T: +44 20 7809 2127

E: [justin.mcclelland@shlegal.com](mailto:justin.mcclelland@shlegal.com)