



HM Revenue  
& Customs

# Protecting your taxes in insolvency

**Summary of Responses**  
**11 July 2019**

# Contents

Summary of Responses .....	1
1 Introduction.....	3
Background .....	3
2. Responses.....	4
Scope of proposal .....	4
3. Next steps.....	12
Annexe A: List of stakeholders consulted.....	13

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# 1 Introduction

## Background

- 1.1 Currently, when an organisation goes insolvent, the taxes that it temporarily holds on behalf of employees and customers may be used to pay other creditors rather than being spent on public services as intended. As such, around £1.9 billion paid by employees and customers each year does not reach the government as was intended.
- 1.2 Therefore, at Budget 2018 the government announced that it will introduce legislation in Finance Bill 2019-20 to make HMRC a secondary preferential creditor for certain debts relating to taxes paid by employees and customers. This reform will raise HMRC from an unsecured creditor to a secondary preferential creditor in insolvencies, but only for VAT, PAYE Income Tax, Employee National Insurance Contributions and Construction Industry Scheme Deductions. This change will ensure that when a business becomes insolvent, more of the taxes paid in good faith by that business' employees and customers will fund public services, rather than these being distributed to other creditors such as financial institutions.
- 1.3 On 26 February 2019, the government published a consultation document "Protecting Your Taxes in Insolvency" which invited comments from interested parties, particularly those affected by this change, on how HMRC can implement this change as effectively as possible. These parties include businesses, lenders, insolvency practitioners, advisors and representative bodies.
- 1.4 The government is grateful to those stakeholders who participated in the consultation process. We received 41 responses, including written responses and those provided in meetings. A breakdown of the representative capacities in which respondents made comments is as follows:
  - 16 representative bodies
  - 16 professional advisors
  - 4 lenders, financiers, and creditors
  - 5 individuals and academics
- 1.5 A list of respondents, excluding individuals, is set out in Appendix A.

## 2. Responses

### Scope of proposal

- 2.1 When a company goes insolvent, the order of distribution for assets from that company is set by law. Currently, many creditors other than HMRC receive higher priority on the assets of an insolvent company – even for taxes paid by employees and customers that the business should hold temporarily before passing onto the government.
- 2.2 From 6 April 2020, the government will change this, so that when a business enters insolvency, more of the taxes paid in good faith by that business' employees and customers will fund public services, rather than these being distributed to other creditors such as financial institutions.
- 2.3 HMRC will remain an unsecured creditor for other unpaid taxes such as Corporation Tax and Employer NICs, and HMRC will remain below other preferential creditors, such as the Redundancy Payment Service.
- 2.4 A small number of respondents, mainly professional bodies, commented on the scope of the proposal. In particular, they asked whether HMRC could make better use of its current powers on debt collection rather than making changes to the order or distribution of assets when a company goes insolvent.
- 2.5 There were also a number of comments, mainly from lenders and financiers, on why this is a stage 2 consultation rather than stage 1 (policy intent).

### Government response

- 2.6 The government is committed to giving HMRC priority for collecting taxes paid by employees and customers to businesses. This is because this represents tax that was paid by citizens with the full expectation that it would be used to fund public services, but under current rules actually gets distributed to creditors instead. Therefore, the government sought views on policy implementation rather than policy intent.
- 2.7 The government is clear that this measure represents a balanced position in protecting taxes that are held by businesses, but which have been paid by employees and customers. When a business goes insolvent, the government understands that the remaining assets may not cover all their tax liabilities. However, the government does not believe it is fair that taxes paid by employees and customers should be diverted to other creditors, when these are only held temporarily by businesses whose role is to transfer these payments to the government. The government view is that this is a fair approach that balances the interests of creditors and the Exchequer, which relies on these taxes to fund public services.

- 2.8 This measure does not seek to address a gap in HMRC's debt collection powers or strategy, but instead seeks to ensure that when a business goes insolvent, the tax paid by employees and customers goes to fund public services. Therefore, the government believes that this legislative change is required.
- 2.9 The government will continue to work with insolvency practitioners and professionals to ensure that the measure is implemented in the most effective way.

**Question 1: The government is committed to increasing the priority of certain tax debts in insolvency. Should they be ranked as a secondary preferential creditor, an ordinary preferential creditor, or protected in some other way in the event of an insolvency?**

- 2.10 A small number of respondents commented that they agree that HMRC should be protected in some way. These respondents also commented on the need for HMRC to make better use of its debt collection powers.

Comments included:

*"HMRC currently have the ability to robustly manage their debt; with powers available to them that are not to other unsecured creditors, including the ability to take enforcement action without a court order to seize assets and an ability to deduct amounts directly from bank accounts. A more consistent and robust approach to debt recovery might help prevent the build-up of significant arrears"*

*"HMRC has the power to issue Personal Liability Notices to corporate officers for a failure to pay National Insurance Contributions (NICs) or future unpaid payroll taxes. HMRC also has the power to insist on upfront security deposits where there is a genuine risk of non-payment of Pay As You Earn (PAYE), NICs or Value Added Tax (VAT). Similarly, HMRC may issue Accelerated Payment Notices for disputed tax debts"*

*"We accept that there is a reasonable argument in favour of HMRC having high priority status for those taxes paid by employees or customers to a party that has subsequently become insolvent. These are taxes that are effectively being collected for HMRC and therefore can justifiably be treated in a different way from other types of taxes"*

- 2.11 Most respondents thought that while implementation of the measure may lead to short-term gain to the Exchequer, this could be outweighed by reduced economic growth, risking reduced tax receipts in the long term. Respondents did not provide evidence to support this view.
- 2.12 One respondent representing a group of insolvency advisors commented that if the government is minded to prioritise its claims under this measure despite some reservations, they consider that HMRC adopting secondary or tertiary preferential creditor status for such claims to be the viable option.
- 2.13 Comments were also expressed by a very small number of respondents that there is a risk that HMRC will become a major petitioning creditor, and that HMRC would have too much influence on the insolvency process.

- 2.14 One respondent wanted clarification on whether preferential status will apply to personal and corporate insolvency.
- 2.15 A small number of respondents commented that secondary preferential status is rarely used presently and creating HMRC as a secondary preferential creditor will add complexity to all insolvency procedures.

## Government response

- 2.16 HMRC would be ranked as a secondary preferential creditor for tax debts affected by this measure for both corporate and personal insolvency. In practice, given the measure would only apply to VAT, PAYE (including student loan repayment), NICs (employee contribution) and Construction Industry Scheme, it will mainly apply to businesses.
- 2.17 The government has no intention for HMRC to exercise increased control over the insolvency process and does not believe that this change will lead to that outcome. HMRC only uses insolvency as a last resort. HMRC will continue to initiate insolvency proceedings to address two situations: (a) to prevent future losses where a business is not viable, ceasing the creation of further charges that the business will not be able to pay to HMRC; and (b) where there is non-compliant behaviour.
- 2.18 The vast majority of insolvency cases fall under the first category, as there tends to be exponential growth in tax debts in the 12 months preceding the insolvency. Therefore, insolvency proceedings will primarily continue to be motivated by the prevention of debt growth.
- 2.19 The government continues to believe that it is best for both tax receipts and the wider economy to assist viable businesses, and will do so through the Time-to-Pay and Business Payments Support Service structure. Currently 720,000 customers are paying £2.3bn of tax debts to HMRC through Time-to-Pay arrangements. These arrangements enable businesses to overcome temporary financial hardship, and more money is recovered to fund public services than would likely be the case in the event of insolvency.
- 2.20 HMRC is continually seeking to improve its ability to recover debt and use its existing powers in the most effective way possible. This change, however, is intended to ensure that when an insolvency has occurred, and taxes paid by customers and employees have not been transferred to the Exchequer, despite our collection activities, HMRC can act to ensure that this money goes to fund public services as intended.

## **Question 2: Would any of the taxes included in this measure pose any particular challenges to insolvency office holders when they process HMRC claims?**

- 2.21 Concerns were expressed by most of the insolvency practitioners that HMRC systems and resourcing already leads to delays in insolvency cases being concluded. If HMRC become a higher ranking creditor in a greater number of insolvencies, respondents commented that HMRC may require additional resources to implement this measure effectively.
- 2.22 Most of the insolvency practitioners and professional advisors expressed concern that given most insolvent businesses are generally not up to date with their returns, HMRC may seek to prejudice the position of other unsecured creditors by issuing excessive assessments, and that this could increase the amount of work to verify these claims.
- 2.23 Most respondents were of the view that penalties and interest arising from tax debts should not be claimed preferentially. Views were also expressed that including penalties would increase administrative burdens on insolvency practitioners who would need to undertake significant work to challenge penalties, particularly those based on behaviour.
- 2.24 There were also a number of comments relating to technical matters on payment allocation between employee and employer contributions, VAT cash accounting, potential impact on Scottish limited partnerships, securitisation, student loan deductions, and notional payments under PAYE.

### **Government response**

- 2.25 The government will continue to work with insolvency practitioners to ensure that this change is implemented in such a way as to minimise any additional administrative burdens on insolvency practitioners.
- 2.26 The government will work with practitioners to ensure that preferential claims submitted under this measure are based solely on tax liabilities incurred prior to insolvency. Furthermore, the government is improving the way that it works with insolvency practitioners. For example, there is now a single point of contact within HMRC. HMRC is also currently exploring the customer journey on insolvency issues, with the aim of reducing contact points and the administrative burden for practitioners. Furthermore, HMRC is continually seeking to improve its processes and guidance. HMRC will work with practitioners to resolve all technical matters (Para 2.24) relating to insolvency claims processing (under this measure) prior to implementation.
- 2.27 The government is grateful for the constructive views and analysis expressed on penalties and interest, and can confirm that these elements will not form part of HMRC's preferential claim. HMRC penalties and interest are aimed at encouraging

compliance, and are not charges paid by employees or customers, but are charges on the business. Any penalties or interest due on taxes which rank preferentially will be claimed non-preferentially alongside other non-preferential claims.

**Question 3: Do you foresee additional administrative burdens falling upon individuals, businesses or insolvency practitioners as a result of this measure? If any, how might they be lessened?**

2.28 Most respondents from the finance community said they expected greater burdens on lenders and businesses because they will now need to factor tax debts into lending reviews in a way that they do not currently.

2.29 A small number of respondents agree that the additional burdens can be managed and that this should not pose particular challenges on claims handling processes, given what is proposed is simply a change in priority. However, a small number of respondents disagreed and considered it would increase the burden on insolvency practitioners.

**Government response**

2.30 The government will continue to work towards minimising the administrative burden for insolvency practitioners, as well as improving its processes and guidance.

2.31 The government view is that tax payments and liabilities should always be factored into business lending decisions. It is right that taxes paid in good faith by employees and customers, and held temporarily by a business, should go to fund public services as intended, rather than being distributed to other creditors, such as financial institutions

**Question 4: Do you consider the objectives of any type of formal insolvency procedure will be adversely affected by this measure? If so please evidence or explain why. Please suggest how we could mitigate against this.**

2.32 There were two primary concerns, mainly from asset based lenders but also from some professional advisors. These were:

- that they expect lenders to lose appetite for lending to SMEs through asset based lending;
- that this may undermine the ability to achieve the first statutory objective of an administration appointment.

Comments included

*“Lenders will be more cautious in their lending, especially in the SME sector, since their security becomes less attractive in the event of a default”*



*“The government’s proposal will have a significant impact on the insolvency framework’s existing rescue procedures: administration and CVA (company voluntary arrangement)”*

2.33 One academic respondent had a different view.

The respondent commented that:

*“We are aware that some commentators have suggested that there would be a significant negative impact in this regard but we are not entirely clear why this would be so. Floating charge-holders may be relative losers as a result of the measure and lenders seeking such a charge may limit their lending accordingly but this is unlikely to affect insolvency processes generally. There is a possibility that such creditors would seek to appoint an administrator at an earlier stage than currently but this could in fact enable a business to be saved by earlier intervention and in fact encourage the rescue culture”*

2.34 A small number of respondents commented that the measure could have a disproportionate effect on Scottish businesses because they have reduced access to fixed charge security due to differences in property law in Scotland.

2.35 Some professional advisors were concerned that the decrease in returns to non-preferential creditors could reduce the engagement of non-preferential creditors in the insolvency processes, contrary to the government’s intentions.

## **Government response**

2.36 The government does not expect this reform to significantly impact access to finance. Consistent with this, the independent Office for Budget Responsibility (OBR) did not make any adjustments to their economic forecast in response to this measure.

2.37 Financial institutions holding fixed charges over assets will remain above HMRC in the creditor hierarchy, and the debts that financial institutions will no longer recover on floating charges as a result of this change represent a very small fraction of total lending in the UK.

2.38 This measure will raise an estimated £185m a year for the government at its peak, and this impact is expected to be spread thinly across unsecured creditors, as well as creditors with a floating charge.

2.39 The UK’s asset-backed finance market totals £4.4bn, while the total SME lending market sits at £58bn. The government therefore does not expect this change to have a negative overall impact on the economy and has not received any evidence in opposition to this view.

2.40 The government will continue to support viable businesses, including those that are under Company Voluntary Arrangement (CVA), through the Business Payments Support Service.

2.41 The government considered the impacts on all constituent parts of the UK when formulating this policy. However, the differences are expected to be relatively small and it is right that across the UK the government acts to protect the taxes that individuals have paid in good faith, intended to go to the Exchequer and devolved administrations. The government will continue to work with stakeholders to ensure effective implementation across all constituent parts of the UK.

### **Question 5: Are there any transitional issues that we need to take into consideration in implementing this measure?**

2.42 Most respondents agreed that the measure should not be retrospectively applied to existing insolvency appointments as this could undermine distributions.

2.43 Most respondents commented that the proposals should be limited to tax debts arising on or after 6 April 2020 rather than insolvencies commencing on or after that date.

2.44 A few respondents commented that the tax debts included in HMRC insolvency claims should be limited to one year or less. It was suggested that this would provide greater certainty to lenders and to some extent mitigate the concerns raised by some respondents regarding the potential negative impact of the measure, as currently proposed on asset based lending.

### **Government response**

2.45 The government will apply this change to insolvencies where the relevant date for making preferential claims is on or after the 6<sup>th</sup> April 2020, i.e. insolvencies that begin on or after that date.

2.46 As the objective of this change is to ensure that when a business becomes insolvent, more of the taxes paid in good faith by that business' employees and customers will fund public services, rather than these being distributed to other creditors such as financial institutions. The rules will remain unchanged for tax debts owed by the business e.g. corporation tax and employer national insurance contributions.

2.47 The government will not set a time limit within which tax debts are included. It is not fair to those individual taxpayers, or to the taxpaying public, if those amounts are lost in liquidation. The government is clear that this measure represents a fair approach that balances the interests of creditors and the Exchequer, which relies on these taxes to fund public services.

## **Question 6: In your view, are there any other considerations, or other potential impacts that HMRC should take into account in implementing this measure?**

2.48 Most respondents, mainly lenders and professional advisors, commented on the question of pre-existing floating charges and stated that the measure should only apply to floating charges created after 2020. Their contention is that the measure will be retrospective if it applies to charges that were created prior to 2020.

### **Government response**

2.49 This measure is not retrospective, as it will apply only to insolvency proceedings after 6 April 2020. Therefore, the measure only has an impact if a business enters insolvency after that date and only relates to the charges that are still due when a business goes insolvent.

2.50 Furthermore, if the measure does not apply to pre-existing floating charges, such an approach could skew behaviour by providing an impetus to retain pre-2020 floating charges unnecessarily, as they would be deemed more valuable than post 2020 floating charges. This could also distort the asset based lending market.

## **Question 7: Do you have any comments on the assessment of equality or other impacts?**

2.51 Many respondents commented that they did not consider the impact assessment adequately addressed the full impacts of the measure, for example the wider economic impact caused by reduced lending. Respondents did not provide evidence to challenge the government's economic impact assessment.

### **Government response**

2.52 While the government anticipates some impact on creditors, it does not expect this reform to significantly impact access to finance. Financial institutions holding fixed charges over assets will remain above HMRC in the creditor hierarchy, and any debts financial institutions will no longer recover on floating charges as a result of this change would represent a very small fraction of total lending in the UK. The Office for Budget Responsibility made no adjustment to its macroeconomic forecast as a result of this measure.

### 3. Next steps

- 3.1 At Budget 2018, the government announced it will introduce legislation in Finance Bill 2019-20 to make HMRC a secondary preferential creditor for certain tax debts paid by employees and customers. This change will ensure that when a business enters insolvency, more of the taxes paid in good faith by employees and customers go to fund public services as intended, rather than being distributed to other creditors such as financial institutions.
- 3.2 The responses to this consultation will inform the draft Finance Bill legislation, which is due to be published in summer 2019. The new rules will take effect from 6 April 2020.
- 3.3 The government will also continue the engagement process with wider stakeholders, including devolved administrations, to ensure that the measure is implemented in the most effective possible manner.

## **Annexe A: List of stakeholders consulted**

### **Representative bodies**

City of London Law Society  
Chartered Institute of Taxation  
Chartered Institute of Credit Management  
Society of Professional Accountants  
Institute of Chartered Accountants in England & Wales  
Insolvency Practitioners Association  
Institute of Chartered Accountants of Scotland  
Chartered Accountants Ireland  
Law Society of Scotland  
Insolvency Lawyers' Association  
British Property Federation  
UK Finance  
Commercial Finance Association (Europe)  
Law Society  
Association of Chartered Certified Accountants  
Association of Business Recovery Professionals (R3)

### **Professional advisors**

Knights PLC  
Moon Beaver  
Freshfields Bruckhaus Deringer LLP  
Johnston Carmichael LLP  
Clifford Chance LLP  
Allen & Overy LLP  
Enterprise Tax Consultants Limited  
RSM Restructuring Advisory LLP  
KPMG LLP  
Squire Patton Boggs (UK) LLP  
Deloitte LLP  
Simmons & Simmons LLP  
BDO LLP  
Grant Thornton UK LLP  
Ashurst LLP  
AlixPartners UK LLP

### **Lenders, financiers and creditors**

Harwood Capital LLP  
Endless LLP  
PNC Business Credit  
Pension Protection Fund