Insolvency Practitioners’ Association

Response to the H M Treasury Consultation Paper
“Protecting Your Taxes in Insolvency”

24 May 2019

About the IPA

The Insolvency Practitioners Association (IPA) is a membership body recognised in statute for the purposes of authorising Insolvency Practitioners (IPs) under the Insolvency Act 1986 and Insolvency (Northern Ireland) Order 1989. It is the only Recognised Professional Body (RPB) to be solely involved in insolvency and for over fifty years the IPA is proud to have been at the forefront of developments and reform within the insolvency profession.

The IPA has approaching 2,000 members and students, of whom approximately 600 are Licensed Insolvency Practitioners. Additionally, the IPA now regulates IPs authorised by the ACCA under a collaboration agreement effective from 1 January 2017.

The IPA’s IPs are subject to a robust regulatory regime, applied by the IPA’s dedicated regulation teams carrying out complaints handling, monitoring and inspection functions.

The IPA has a longstanding and continuing commitment to improving standards in all areas of insolvency (and related) work. It was the first of the recognised bodies to introduce insolvency-specific ethics guidance for IPs, and the IPA continues to be a leading voice on insolvency matters such as the development of professional standards, widening access to insolvency knowledge and understanding, and encouraging those involved in insolvency case administration and insolvency-related work to acquire and maintain appropriate levels of competence and skills.

The comments and opinions expressed below represent the views of the IPA’s relevant committees, and are not intended to reflect the opinion of each individual and firm member of the IPA. Our comments in this response are based primarily on our role as an RPB.

We set out below our responses to the specific questions within the Consultation Paper. Further enquiries should be addressed to:

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Introduction

The IPA welcomes the opportunity to comment on H M Treasury's policy proposal to make HMRC a secondary preferential creditor for taxes paid by employees and customers in formal insolvencies.

The Consultation Paper acknowledges that prior to the Enterprise Act 2002 coming into effect, HMRC was a preferential creditor for certain taxes, but since 2003 their status had been reduced to that of non-preferential creditor for all forms of tax.

Since then HMRC has continued to be a non-preferential creditor and the Consultation Paper states that losses to the exchequer from insolvency have increased. Consequently, the government decided that from April 2020 certain tax debts should be protected in an insolvency because they are taxes that have been paid by employees and customers and being held by the business on behalf of HMRC.

The proposal is therefore arguably to be seen as primarily a tax revenue recovery measure rather than a departure from the policies of promoting the 'rescue culture' which underlay the Enterprise Act 2002. The Consultation Paper does not, however, state whether the anticipated revenue generated by the measure, of up to £185 m in 2022/23, represents funds that would otherwise have been distributed to ordinary unsecured creditors.

The impact of this consequence on trade and expense creditors may need further assessment to determine whether it is likely to undermine the rescue culture and how sensitive the anticipated revenue is to such a change.

We would respond to the questions raised in the consultation paper as follows:

Reintroduction of Preferential Status for Certain HMRC Claims in Insolvencies

HMRC Consultation "Protecting Your Taxes in Insolvency"

Question 1:	Response
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?	Provided that the 'preferential status' is limited to deductions from employees pay there is some justification for this. They are akin in some respects to 'Trust' monies, although 'Trust' monies themselves, such as customer deposits, are not afforded any priority if they are not ringfenced and kept in a separate account. However, HMRC also treats some tax charges as though they were PAYE deductions even when they were not treated as such by the employer. For example 'Loan Charges' which HMRC regards as disguised remuneration.

	The proposal includes VAT, also on the basis that it has been collected on HMRC's behalf. These claims can be material to an insolvency. Any preferential status should not, in our view, extend to interest and penalties on overdue deductions as these are intrinsically different from deductions from employees that have not been paid over or VAT that has been collected from customers. Including such additional charges would be inequitable and appears inconsistent with the argument that the basis of the proposed preferential status is that the funds have already been collected on behalf of HMRC. The current proposal is for HMRC to be a secondary preferential creditor and this will leave employees the extra protection currently afforded them. The proposal states that no time limits will apply to the debts to which the new secondary preferential status will apply. This will clearly maximise the redistribution of funds in insolvent estates away from floating charge holders and ordinary unsecured creditors and towards HMRC. It is a departure from the precedent of time limits applying to preferential creditors which existed before the Enterprise Act 2002 came into force. If there was a time limit under the proposed treatment of HMRC debts it may be that such an element could rank as ordinary preferential but as it stands but it would not be equitable for the full amount to be treated as such. Maybe there should be a split (as there is in a different way with the FSCS deposits) where 6 months could be ordinary preferential and the rest secondary?
Question 2:	
Would any of the taxes included in this measure pose any particular challenges to insolvency office holders when they process HMRC claims?	Deductions from earnings and payments to HMRC should be easily ascertained from an employer's records. In many insolvency appointments such records are not fully reliable so additional administrative work may be required to agree the secondary preferential claims.

	'Loan Charges' mentioned above may relate to loans or other forms of credit created after 6 April 1999 which have been written off in the employer's records. The IP may not be aware of them and or the relevant records may no longer be available to enable the IP to properly consider any claim made by HMRC. Similarly agreeing long outstanding VAT liabilities may be problematic.
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?	In any categories without time limits there will be an additional burden in terms of obtaining and extracting information from the insolvent's books and records to enable secondary preferential claims to be agreed. If, for example, even if there was little prospect of a dividend for unsecured creditors more extensive historical accounting work might still be required to ascertain the extend of the preferential claims. It will be necessary to agree the HMRC preferential claim in order to declare a dividend which will be made more difficult without time limits on such claims and delay distributions to all creditors. By way of note, HMRC currently take a long time to issue penalties etc. If the submission of secondary preferential claims was, itself, subject to time limits there would be additional certainty in finalising such claims with consequent administrative benefits.
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.	If significant sums fall into this category there could be implications if unsecured creditors face no return at all. Again, perhaps there should be a time limit on preferential element? Even secondary preferential status would negate any benefit to unsecured creditors. HMRC could mitigate the risk by adopting more proactive and rigorous collection procedures. The impact on floating charge holders could be a disincentive to continued lending to distressed businesses and consequently reduce the possibility of continued trading in Administration or CVA.

	Rescue procedures are likely to be affected as there will be additional hurdles to overcome to obtain new funding. Dividend prospects will also be adversely affected for unsecured creditors and it will be more difficult to obtain creditor engagement e.g. on the possibility of pursuing antecedent recovery proceedings and indeed on fee and cost approval. The ability to propose CVAs and IVAs may well be undermined by the fact that HMRC could take a majority share of all distributions for an extensive period which could result in the general body of unsecured creditors not supporting voluntary arrangements as they may well not get a distribution until much later in an arrangement.
Question 5:	
Are there any transitional issues that we need to take into consideration in implementing this measure?	• Clarification of the categories of preferential creditor when successive insolvency procedures straddle the date of reintroduction of preferential or secondary preferential status. • The need to ensure that transitional provisions apply so that the new secondary preferential status will only apply to new cases not to all open cases which happen to be in train at the time the legislation takes effect – and where distributions to unsecured creditors may have been made.
Question 6:	
In your view, are there any other considerations, or other potential impacts that HMRC should take into account in implementing this measure?	The proposal appears to assume the impact on financial institutions will not be material although no evidence to support this view has been produced. We consider that such evidence is required to justify this assumption.

Question 7:	
Do you have any comments on the assessment of equality or other impacts?	The figures quoted in the proposal compared the £185m annual yield to HMRC, i.e. the redistribution away from ordinary unsecured creditors and floating charge holders, with total bank lending to small and medium enterprises rather than with lending to enterprises that become insolvent. This understates the significance of the change and does not reflect the impact the proposed change will have on the risk of loans to such enterprises. The redistribution effect is also likely to be understated due to the unlimited period proposed over which the new secondary preferential claims can relate. HMRC, as a preferential creditor, will need to be much more actively engaged in insolvency cases, as they are likely to have the primary economic interest. This includes consideration of Administration proposals, supporting proposed recovery actions by the office holder and consideration of fee resolutions.