

A background image showing a close-up of several silver coins, likely British pounds, arranged in rows. One coin is slightly out of focus in the foreground, showing the profile of a monarch and the year '2009'.

HMRC / PRIORITY ON INSOLVENCY

HMRC's long-awaited secondary preference will arrive on 1 December 2020. But what does it mean for creditors?

BY MATTHEW RICE

The Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations were made on 11 September 2020 and come in to force on 1 December 2020.

The regulations set out HMRC's much maligned secondary preferential status in insolvencies. The change has not been unexpected, and will have a profound effect on the amount creditors may receive.

The preference will only be in respect of PAYE income tax, employee National Insurance Contributions, Construction Industry Scheme deductions and student loan repayments. VAT will also be treated in the same way but is not covered by these specific Regulations.

HMRC will however remain an unsecured creditor for direct taxes including corporation tax and employer national insurance contributions.

The Purpose

The preference, which is criticised for rolling back the clock to 2003, has been widely publicised by the Government which has taken steps to promote the measure on its website and elsewhere. The Government generally describes the measure as ensuring that *"more of the taxes paid in good faith by [a company's] employees and customers and temporarily held by the business, will go to fund public services rather than being distributed to other creditors."*

The principle seems to be that monies paid in tax by an employee or customer ought to be held on some form of loose trust for the Exchequer. This rationale has been heavily criticised by Insolvency Practitioners and practice groups including R3 .

The Treasury's takings are estimated to rise by £185 million a year as a result of HMRC's new preference in insolvency.

Secured Lenders

Secured lenders' fixed charge security will be unaffected by the Regulations and they continue to rank ahead of HMRC's preferential status.

HMRC's new preference will serve to 'leap-frog' lenders with floating charge security. This will be the case for any formal insolvency process commenced after 1 December 2020 regardless of when the floating charge security was effected.

There is a double blow comes for secured creditors in that the Regulations provide for no limit, in value or time, to HMRC's claim to the secondary preference. This is a clear risk management consideration for lenders at a time when elsewhere, tax liabilities are being postponed in response to the Covid-19 pandemic.

Lenders will need immediately to consider their portfolios with particular focus on borrowers subject to floating charge security that are in financial distress. The effect of the preference may well mean that the value of a lender's security may be wiped out, or at least substantially reduced, overnight.

Lenders with new floating charge securities created on or after 6 April 2020 will also need to remember that the increase to the prescribed part from £600,000 to £800,000 will also effect the value of their security.

Whether a lender should consider pushing for a restructuring or insolvency procedure prior to 1 December 2020 is a decision that they should take very seriously and is likely to be highly fact specific.

Restructuring

It is often noted, but bears repeating, that the Covid-19 pandemic has seen unique strains on business and that there clearly is a market for restructuring and turnaround financial products. Risk adverse lenders are likely to be less able to offer financial support to businesses without fixed asset-backed security and may no longer feel able to rely on floating charge assets to support a prospective borrower's growth.

The new preference has effect equally among lenders. As such, refinancing with alternative lenders is also going to be increasingly challenging.

Lenders when conducting their due diligence will need to consider the tax affairs of any potential borrowers. This due diligence requirement will be ongoing and any restructure or refinance is going to come with obligations to deliver to the lender full and proper information on the company's tax affairs throughout the life of the facility.

The additional administration required and risk taken on by lenders is likely to be reflected in the pricing of facilities made available to prospective borrowers.

Unsecured Creditors

It is simply logical that funds that previously would have been shared equally among unsecured creditors will be reduced as a result of the new priority. Both the prescribed part and the end funds available to unsecured creditors are likely to be dramatically affected. The 'ripple' effect this will have on suppliers is yet to be seen, but it is hard to envisage how this would not result in some financial decline for supplier businesses.

Getting Advice

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