Protecting your Taxes in Insolvency: CIOT response

Management of taxes

01 July 2019

CIOT recently responded to HMRC’s consultation on making HMRC a preferred secondary creditor for certain tax debts paid by employees and customers.

The government is proposing to introduce legislation that will make HMRC a preferred secondary creditor for VAT, PAYE, employee NICs and CIS deductions. The new rules will come into force for insolvencies that commence from 6 April 2020. HMRC will remain an unsecured creditor for taxes directly on businesses, such as corporation tax and employer NICs. In other words, the consultation is proposing partially to restore Crown preference which was abolished in 2003.

The policy objective of the measure is the protection of payment of tax debts due from employees and customers of a business, but in our response to the consultation we express reservations about how successful this proposal will be at delivering the policy objective. We identify some practical, and possibly adverse, consequences that could arise as a result of implementing the change.

We think that there is a risk that the proposal could lead to an increase in insolvencies. When Crown preference was removed in 2003 by the Enterprise Act 2002 one reason for that was to try to keep viable businesses afloat and to prevent lenders further down the ranking order ‘pulling the plug’ earlier than they needed to for fear of not getting paid. Crown preference was generally considered to be unfair to other unsecured creditors, in that arguably it disincentivised HMRC to manage its own exposure and incentivised HMRC to push a business into an insolvency procedure. This new proposal does not appear to mitigate against the risks which saw removal of Crown preference in 2003, and the impact assessment does not address them at all.

We would like HMRC to produce a more comprehensive impact assessment which fully addresses the likely effects of this proposal across the wider economy. Until this is done, we cannot be satisfied that the projected Exchequer yields will sufficiently outweigh the likely increase in costs to business and/or reduction in lending to justify this change.

HMRC are already in a unique position compared to other creditors. They already have many powers that are not available to other unsecured creditors which they can use to minimise the risks to the Exchequer from a business defaulting on its tax debts (we list many of them in our response). Given this, we question why HMRC believe it is necessary for them to take the further powers proposed in this consultation document.

Given the amount of information and powers already available, and soon to be available, to HMRC, it would also be helpful for businesses and their advisers to understand in what order of priority HMRC propose to use them.

The change applies to insolvencies commencing from 6 April 2020, meaning that it will apply to tax debts that arose before the legislation was enacted. In other words, the rules come into force after the transaction or supply that gave rise to the debt has occurred so that there is an element of retroaction. Non-preferential creditors who are owed money for pre-6 April 2020 transactions will be pushed down the order of distribution as a result of this change and could end up recovering less of their money as a result. This could be regarded as unfairly giving HMRC an added advantage over other creditors. It might also lead to non-preferential creditors becoming more risk averse than they might already be in the lead up to next April when dealing with companies who may be known or perceived to be in financial difficulties. In our view, it would be fairer if the proposals were limited to debts arising on or after 6 April 2020 rather than insolvencies commencing on or after that date.

The consultation document is proposing that any penalties or interest arising from the taxes will also form part of HMRC’s preferential claim. We do not agree with this proposal. Penalties and interest are debts due from the business not the employee or customer and should not form part of HMRC’s preferential claim.

In our view, this proposal would have greatly benefited from being started as a Stage 1 (‘Setting out objectives and identifying options’) consultation. Instead, the

consultation has started at Stage 2 of the consultation process (‘Determining the best option and developing a framework for implementation including detailed policy design’) since the decision to introduce this legislation was announced at Autumn Budget 2018 without any prior consultation. Earlier consultation has the benefit of allowing stakeholders to engage and contribute on a range of possible options at an early stage which in our opinion leads to better policy.

We suggest that the government consider pausing these proposals so that the whole situation as regards HMRC’s powers in this area can be looked at together and coherent new proposals introduced, if considered necessary, following a Stage 1 consultation.

The full text of the CIOT’s submission can be found on the CIOT website.

HMRC’s consultation document can be found on GOV.UK.