

New preference

Tom Jarvis, David Jacob and Stephen Parker explain how UK insolvency priorities are likely to change as a result of the Budget announcement.

As part of the UK Budget, the Treasury announced that, as of April 2020, HMRC will have greater priority to recover particular taxes paid by employees and customers but held, in its words, 'in trust' by a company that goes into insolvency. At present, there is no detail as to how this change will be implemented, other than that the taxes covered by the preference will include VAT, PAYE, employees' National Insurance contributions and construction industry scheme (CIS) deductions. However, other taxes payable by a company on its own behalf – such as corporation tax and employer's NICs – would not have priority status.

Regime reversal

It is worth noting at the outset that, in the strict legal sense, VAT, PAYE, employees' NICs and CIS deductions are not held 'in trust' by a business. If they were, they would be protected automatically on an insolvency because they would not form part of the insolvent company's assets. Rather, they are collected by a business through, in the case of VAT, increasing the price of its supplies and, in the case of PAYE, employees' NICs and CIS deductions, withholding from the payments it makes. This change is something of a surprise, particularly given that The Enterprise Act 2002 abolished Crown preference in 2003. That reform was part of a wider package of changes to the UK insolvency regime and the result of careful consideration of the lessons learned from the earlier experience of company insolvencies, particularly during the recession of the early 1990s.

It is clear why the proposal may be attractive in the current national climate: the policy seems to be that, if tax has been collected from taxpayers – employees, customers and suppliers – by a firm on behalf of HMRC, it should be passed to the department and not used, say, to prop up the working capital requirements of a struggling business. After all, why should the public coffers be used to help a business trade out of a precarious economic position? That, looked at in isolation, makes perfect sense. However, some taxes have long been collected by business on behalf of HMRC and presumably that feature of the tax system would have been taken into account in abolishing the Crown preference. It would therefore be helpful to understand, given the policy trade-offs that were delicately balanced to arrive at that outcome in 2002, what has driven the change in approach.



Collection or liability?

It is still not clear whether the new preference would apply only in a scenario where the business 'collects' the tax concerned – or, in the Treasury's terms, holds the tax 'in trust'. For example, PAYE and employees' NIC liabilities can arise if non-cash benefits have been given to employees. In such cases, and depending on the circumstances, a further liability can arise if the business then fails to recover the tax from the employee – in effect, bearing the employee's tax as a benefit in kind. A business may also fail to pass a VAT charge on to a customer, say when it does not believe the supply to be taxable, and HMRC later successfully challenges this.

It is understood that, quite sensibly, the government intends to consult on the proposal later in the year. Hopefully, this will provide businesses and insolvency and restructuring advisers the opportunity to raise issues on how the new policy would work and the impact on future restructurings. However, it is clear there may be an impact on secured creditors in relation to the amount realised from floating charge security, which is likely to be relevant for book debts and cash held in bank accounts. That may increase the risk for lenders and raise the cost of financing. For unsecured creditors, it will be important to take any available steps to improve their position on an insolvency, for example by ensuring that any retention of title arrangements is robust and enforceable. ●

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