Written evidence submitted by the Chartered Institute of Taxation (FB21)

Representation to Finance Bill 2020 Public Bill Committee

Clauses 95 and 96
HMRC Debts: Priority on Insolvency

Executive Summary

This strengthens HMRC's ability to claim money it is owed when a business becomes insolvent, at the expense of other creditors. The timing of this measure is particularly significant as it is set to take effect around the time temporary help for businesses suffering as a result of COVID-19 might be withdrawn (which could see a spike in insolvencies).

1. Overview

1.1 Clauses 95 and 96 provide that from 1 December 2020, when a business enters insolvency, HMRC will become a secondary preferential creditor for amounts described as being collected and held by businesses on behalf of other taxpayers; namely VAT, PAYE Income Tax, Employee NICs, student loan deductions and Construction Industry Scheme deductions. HMRC will remain an unsecured creditor for taxes directly on businesses, such as corporation tax and employer NICs.

1.2 The order of asset distribution in insolvency is set out in the Insolvency Act 1986. Broadly, asset realisations are paid out in the following order:

1. Secured creditors with a fixed charge (after costs of realisation) (eg a bank who holds security over a specific asset)
2. Insolvency practitioners' fees and expenses
3. Ordinary preferential unsecured creditors (eg employees entitled to arrears of wages, and deposits that fall within the Financial Services Compensation Scheme (FSCS))
4. Secondary preferential unsecured creditors (eg those parts of a deposit which do not fall within the protection of the FSCS)
5. Prescribed part creditors (fund ring-fenced to pay a limited dividend to non-preferential unsecured creditors)
6. Secured creditors with a floating charge (assets subject to a floating charge often include stock, raw materials, work-in-progress, etc)
7. Non-preferential unsecured creditors (eg trade creditors, suppliers, customers, contractors, some staff claims)
8. Shareholders or individual (In a company insolvency, shareholders are the final group to be paid)

Each class of creditor must be paid in full before the insolvency officer holder can distribute funds to the next group. The proposal is that, for the taxes specified, HMRC moves up from the seventh of these categories to the fourth.

1.3 The commencement of the measure (which was announced at Budget 2018 without any prior consultation) has been delayed from 6 April 2020 to 1 December 2020 and now applies to insolvencies occurring on or after 1 December 2020. The measure is extended to Northern Ireland.

1.4 Consultation on this measure was begun at stage 2 (determining the best option and developing a framework for implementation including detailed policy design) of the government's tax consultation framework[1] rather than stage 1 (setting out objectives and identifying options). In our view, this proposal would have benefited from being started as a stage 1 consultation.

1.5 There are uncertain and possibly unforeseen consequences that could arise from the interaction of Clause 95 and measures that have been announced by the government in response to the COVID-19 crisis. The potential impact of these measures should be a factor in determining whether clause 95 should take effect on 1 December 2020, or be postponed to a later date.

2. Detailed comments

2.1 During the consultation process, we expressed concerns that:

- the proposal could lead to an increase in insolvencies (partly because of a perception that HMRC have been more focussed than some other creditors on pursuing claims forcefully; and partly because a creditor with preferential status is more likely to receive all, or a significant part of their debt, in the case of bankruptcy and so is more motivated to take difficult steps to enforce it than an unpreferenced creditor who might only expect to receive a small fraction if anything),
- the consultation had commenced at 'stage 2',
- the measure applied to insolvencies commencing from 6 April 2020 (meaning that it would apply to tax debts that arose before the legislation was enacted), and
- a number of practical queries arise (such as how amounts of payroll taxes paid by employers will be apportioned between the employer (non-preferential) and the employee (preferential) elements.

2.2 Clause 95 simply defers the effective date and does not address these operational concerns.

2.3 Since the Finance Bill was published, HMRC have announced that:

a) UK VAT registered businesses may defer VAT payments due to the COVID-19 crisis[2]. VAT payments due between 20 March 2020 and 30 June 2020 can be deferred to a later date but must be paid on or before 31 March 2021.

b) that businesses which are in temporary financial distress because of COVID-19 should access HMRC's Time to Pay[3] service for help and advice regarding payment of other outstanding tax liabilities.

2.4 It would appear that the provisions in Clause 95 will apply to any VAT that has been deferred under the COVID-19 relaxation measure and is unpaid at 1 December 2020. Similarly, it will

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[1] Tax Consultation Framework, HM Treasury / HMRC, March 2011
https://www.gov.uk/government/publications/tax-consultation-framework

[2] https://www.gov.uk/guidance/deferral-of-vat-payments-due-to-coronavirus-covid-19

[3] https://www.gov.uk/government/organisations/hm-revenue-customs/contact/coronavirus-covid-19-helpline

apply to any other relevant taxes (such as PAYE) and other VAT liabilities which have not been paid by businesses by that date due to financial distress linked to the coronavirus outbreak.

2.5 In addition to the above measures, the government announced on 28 March 2020[4] that insolvency laws will be adapted to allow struggling businesses to continue trading during the coronavirus crisis, including allowing a temporary suspension of wrongful trading provisions for company directors, removing the threat of personal liability during the pandemic. This will apply retrospectively from 1 March for three months.

2.6 Whilst the full implications of the COVID-19 emergency measures are unclear at present due to the high levels of uncertainty about what will happen to the economy in the coming months, it would appear likely that affected businesses will be building up big debts over the next few months and HMRC will *prima facie* be in a better position than other creditors where businesses become insolvent on or after 1 December 2020 due to the change in the insolvency rules.

2.7 Finally, we note that Budget 2020 also announced 'investment in HMRC to improve tax compliance' and an expectation of increased revenues of nearly £4 billion by the end of 2024-25. Part of this revenue will come from 'expanding debt collection capabilities' and we wonder whether these measures will overlap.

3. The Chartered Institute of Taxation

3.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

3.2. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

3.3. The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

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[4] https://uk.finance.yahoo.com/news/government-reshapes-insolvency-laws-due-174648733.html?guccounter=1