Protecting your Taxes in Insolvency: HMRC consultation
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to respond to HMRC’s consultation document ‘Protecting your taxes in insolvency’ which was published on 26 February 2019. This is the first public consultation on the issue.

1.2 Legislation will be introduced to make HMRC a preferred secondary creditor for certain tax debts paid by employees and customers (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.

1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.4 Our stated objectives for the tax system which are relevant to this consultation include:

- A legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

2 Executive summary

2.1 We note the policy objective of protecting payment of tax debts due from employees and customers of a business. We are not certain how successful this proposal will be at delivering the policy objective. We have
identified a number of practical, and possibly adverse, consequences, which we set out in more detail below, that could arise as a result of implementing the change.

2.2 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.

2.3 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.

2.4 HMRC are already in a unique position compared to other creditors. They already have many powers that are not available to other unsecured creditors (see paragraph 3 below) which they can use to minimise the risks to the Exchequer from a business defaulting on its tax debts. Given this, we question why HMRC believe it is necessary for them to take the further powers proposed in this consultation document.

2.5 In the response document ‘Insolvency and Corporate Governance’ published on 26 August 2018 by the Department for Business, Energy and Industrial Strategy1 (see also related comments in the press2), the Government appears to be signalling its intention to push employees’ pay and pension payments up the agenda when a company gets into financial difficulties. We are not sure how the proposals in HMRC’s consultation document on protecting taxes in insolvency fit with this. The proposed legislation needs to make clear what the order of precedence is.

2.6 We are disappointed that this consultation has started at Stage 2 of the consultation process (‘Determining the best option and developing a framework for implementation including detailed policy design’) not at Stage 1 (‘Setting out objectives and identifying options’), with the proposal to introduce legislation to make HMRC a secondary preferential creditor for taxes paid by customers and employees having already been decided and then announced at Autumn Budget 2018 without any prior consultation. In our view, this proposal would have greatly benefited from being started as a Stage 1 consultation.

2.7 The report by the CIOT, Institute for Government and Institute for Fiscal Studies ‘Better Budgets: Making tax policy better’3 published in January 2017 recommended starting consultation at an earlier stage. The 2011 Tax Consultation Framework4 with its five-stage approach to tax policy making, committed the Government to, where possible, ‘engage interested parties on changes to tax policy and legislation at each key stage of developing and implementing the policy’ and to consult earlier on changes. Although this may lengthen

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1 INSOLVENCY AND CORPORATE GOVERNANCE - Government response

2 See comment from the BBC on 26 August 2019 - https://www.bbc.co.uk/news/business-45302629


4 HM Treasury and HMRC Tax Consultation Framework March 2011
timescales, it would have the benefit of allowing stakeholders to engage and contribute on a range of possible options, leading to better policy. Consultation on the options that emerge would then be the second stage of the process, with draft legislation to follow.

2.8 Lastly, we suggest that the government should consider pausing these proposals so that the whole situation can be looked at together and coherent new proposals introduced, if considered necessary, following a Stage 1 consultation.

3 Question 1: 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?

3.1 In our view, there is nothing in the consultation document which justifies or argues for the ‘ordinary preferential creditor’ status. That would mean HMRC would rank alongside employees for payment, which may mean there is less money to pay employees (some of whom will be on low wages). Consequently, we do not consider there is any justification for giving HMRC ordinary preferential creditor status.

3.2 We also note that the announcement made at Autumn Budget stated that ‘from 2020, HMRC will become a secondary preferential creditor for taxes held on behalf of employees and customers’ which indicates that the decision has already been made to give HMRC secondary preferential creditor status. If the decision has indeed already been made, we are not clear why the question is being asked. As noted above, our preference is for this proposal to be paused and a Stage 1 consultation process to be undertaken to look at all HMRC’s powers related to protecting payment of tax debts.

3.3 It is debatable whether the proposal to make HMRC a secondary preferential creditor may be necessary at all. As outlined in the following list, HMRC already have, and will shortly obtain more, powers to obtain payment for PAYE and other tax debts from businesses. These include:

- This proposal to make HMRC a secondary preferential creditor as outlined in the consultation document;
- The tax abuse and insolvency legislation which is to be included in the next Finance Bill;
- The existing legislation which enables HMRC to collect PAYE and employees NICs from employees or directors or other persons in certain situations (PAYE Regulations (SI 2003/2682) Regs 72 and 80/81, 972B, 97ZI and 97C, SS(C) Regulations (SI 2001/1004) Reg 86 and SSAA 1992, S.121C);
- HMRC receive real time information from employers and monthly returns from CIS contractors which can enable them to take recovery action promptly where due payments are not received;
- HMRC can already demand security for tax debts like PAYE, NICs and VAT, and this is shortly going to be extended to include corporation tax and CIS deductions. This power already gives HMRC protection when they are worried that a business may become insolvent;
- The existing legislation which enables HMRC to collect deliberate behaviour penalties from directors/officeholders (rather than the company) if the deliberate error or failure was attributable to their behaviour (FA 2007, Sch 24, Para 19 and FA 2008, Sch 41, Para 22);
- The existing legislation which gives HMRC the power to instruct banks and building societies to deduct amounts to settle taxpayers' tax debts directly from their bank accounts (Finance (No 2) Act 2015 Sch 8);
- HMRC recent consultation on introducing an alternative method of VAT collection known as ‘split payments’ explored how they could use card payment technology to collect VAT on online sales and transfer it directly to HMRC;
- HMRC can negotiate time to pay agreements with businesses to help ensure tax debts are paid in a manageable and structured way;
- HMRC can seek a court order for payment of outstanding taxes. If such an order is granted and appropriate notice is served, an enforcement officer may enter any premises used for the debtor’s trade or business and take control of goods owned by that person (as far as possible not exceeding the value of the debt due).

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

4 Question 2: Would any of the taxes included in this measure pose any particular challenges to insolvency office holders when they process HMRC claims?

4.1 HMRC’s systems do not allow an employer to allocate payments of NIC. So, if only part of a NIC liability is paid, how will that be allocated between employer and employee contributions, and who will decide how it is allocated? A concern is that if it is HMRC that allocate the payment, they will want to allocate it first to employer contributions so they can claim preference on the employee element.

4.2 Where a business does not use VAT cash accounting, it still needs to pay VAT on its invoices even if a customer has not paid them, unless and until bad debt relief can be claimed. This means that, unless there are provisions to the contrary, that VAT would become part of a preferential creditor for HMRC even though the business has not been paid it. It does not seem fair if HMRC could claim this as a preference, particularly if non-payment of the debt is one of the reasons that the business has become insolvent in the first place. In our view, the proposal should not apply to VAT on debts due from customers that have not been paid at the time the business becomes insolvent. The VAT should remain in the unsecured creditors category.

4.3 Similarly, if a business has not paid its employees, then the associated PAYE/NICs should not fall within these proposals. This situation could arise where an RTI submission has been made ‘on or before’ payment is due but the employer then does not pay the employees, or does not pay the employees in full.

4.4 Also, note that under s.686 ITEPA 2003 for PAYE purposes a payment is treated as made at the earliest of:

1. The time when the payment is made.
2. The time when the person becomes entitled to the payment.
3. If the person is a director, the time when payments are credited in the company’s accounts, or the time when the amount is determined.

Thus, in theory, a payment can arise, and thereby a liability to account for tax under PAYE, before it is made. And, if the payment is not made and the company has gone into liquidation, there ought not be a requirement to pay over the PAYE that was ‘due’.

4.5 It is not clear what the position would be if there is a dispute between the business and HMRC (or a third party) (eg over whether a transaction is subject to VAT or over whether services supplied are such that there is an employment relationship, where PAYE etc is due, or a self-employment/worker one, where PAYE is not due). They may all have tax consequences that need to be ascertained and resolved, not least the actual amount of tax that is owed. The uncertainties on the interaction between the dispute and the proposed new legislation may make the liquidation lengthier and more complex. Also, we do not think it would be appropriate for HMRC to wind up a business in order to use its secondary preferential creditor status to collect a disputed amount of tax.
4.6 Similarly, will HMRC have to exhaust other methods of collection (for example, the transfer of debt provisions in respect of certain PAYE and NIC liabilities) before a liability falls into the preferential category?

4.7 It is not clear what would happen if there is an ongoing HMRC enquiry or appeal in relation to VAT, PAYE, employee NICs or CIS when the company goes into liquidation. It is a fact that HMRC do already apply to the courts for winding up orders against some businesses and for bankruptcy of individuals if there are ongoing unpaid tax debts. These applications occur despite the existence of pending unresolved tax appeals awaiting hearing by the Tribunals/Courts. Such applications may succeed if the Court considers that there is a low chance of success of the appeal against the tax liability succeeding, in other words if the appeal is deemed to lack merit. The business must provide the evidence to satisfy the court that their appeal has merit but may lack the resources to engage tax counsel and present their case properly if the business is in financial difficulties. If the proposals in this consultation document are enacted unchanged then HMRC may be considered to have a particularly powerful position in relation to the debt if HMRC are seeking an order to put the business into an insolvency procedure in which HMRC will have preferential status.

4.8 It is not clear whether income tax payable by the employer under ITEPA 2003 s.222, by virtue of ss.687, 687A, 689, 689A, and 693 to 700 and the requirement to account for income tax on notional payments by virtue of s.710(4), would be (if unpaid on insolvency) – or would be intended to be - within the new HMRC preference. If so, would the position be different if the employer has not recovered the tax from the employee? Such obligations arise in connection with tax liabilities on notional payments (mainly employment-related securities income). A similar point arises where an employer undertakes to meet the UK income tax liability arising from the UK earnings of a foreign national employee under tax equalisation arrangements.

5 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?

5.1 We can foresee additional administrative burdens being created due to the risk of lenders becoming more risk averse (see paragraph 8 below).

6 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.

6.1 No comments.

7 Question 5: Are there any transitional issues that we need to take into consideration in implementing this measure?

7.1 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

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5 See for example Changtel Solutions UK Ltd (formerly Enta Technologies Ltd) v Revenue and Customs Commissioners [2015] EWCA Civ 29 and Parkwell Investments Limited v Wilson (as Provisional Liquidator of Parkwell Investments Limited) & HMRC [2014] EWHC 3381 (ChD)
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 is what is going to happen with post 6 April 2020 debts anyway, but because with pre 6 April debts we are talking about retroaction it 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.

8  Question 6: In your view, are there any other considerations, or other potential impacts that HMRC should take into account in implementing this measure?

8.1 Paragraph 3.11 of the consultation document says 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.

9  Question 7: Do you have any comments on the assessment of equality or other impacts?

9.1 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.

9.2 The impact assessment does not fully assess the impact on a business’s other creditors who currently rank below preferential status. Financial institutions and lenders holding a floating charge may want more information about a business’s financial position and its tax debts before lending to it, for example. This will increase administration time and costs for business and may lead to a reduction in lending. They may also demand more security (i.e. a fixed charge) to ensure they continue to rank ahead of HMRC. This will push other holders of floating charges and unsecured creditors further down the ranking order.

9.3 It could lead to lenders becoming more risk averse generally. One consequence of this is an increase in the cost of borrowing / interest rates across the board for all businesses due to the increase, actual or perceived, in lending risk. Another is that finance options could be reduced. We do not agree therefore with the statement on economic impact in the impact assessment that ‘the government does not expect [the change] to have a material impact on lending’.

10  Acknowledgement of submission

10.1 We would be grateful if you could acknowledge safe receipt of this submission and ensure that the CIOT is included in the List of Respondents when any outcome of the consultation is published.
11 The Chartered Institute of Taxation

11.1 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.

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.

The CIOT’s 18,500 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.