Europe Chapter | Secured Finance Network EUROPE

*Commercial Finance Association Europe is becoming Secured Finance Network Europe*

***By email & post*** 23rd May 2019

Ade Adetosoye
HMRC – Debt Management
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Dear Sirs

**Protecting your Taxes in Insolvency: HMRC Consultation**
**Response by the Commercial Finance Association (Europe)**

Founded in 1944, the Commercial Finance Association, soon to become the Secured Finance Network, is the international trade organisation representing the asset-based lending, receivables discounting, factoring, trade and supply chain finance industries, with over 1,000 member organisations who employ over 60,000 people throughout the U.S., Europe, Canada and around the world. Nearly 100 of these organisations are located in the UK and/or active in our UK Chapter.

CFA provides information, education, networking opportunities and industry advocacy to the global secured finance community who at year end 2018 collectively have over $4T in capital deployed, some £50B of which funds primarily middle market UK companies who in turn drive material economic growth and employment in this region. These borrowers, as well as the lenders we represent would be negatively impacted by the HMRC measure.

For more information on CFA, please visit www.cfa.com and download the Secured Finance Industry 2018 Market Sizing and Impact Study conducted in conjunction with Ernst and Young, or contact us directly.

The Commercial Finance Association (Europe) Ltd have prepared this response in response to HM Revenue & Customs' consultation paper "*Protecting your Taxes in Insolvency"* published on 26 February 2019.

**Executive Summary**

We believe that these proposals would have an adverse effect on existing lending, new enterprise and future investment in the UK economy by:

1. Creating liquidity issues for businesses because lenders will have to make bigger provision to cover the lending risk;

2. Increasing the cost to lenders as a consequence of the difficulties of assessing borrowing risk due to the unquantified level of HMRC's claim;

3. Increasing borrowing costs and increased administration costs to borrowers who will be required to report more frequently to lenders to enable lenders to assess their provisioning;

4. Causing immediate business distress and potential business failures as a result of there being no transitional provisions;

5. Reducing available finance options to corporates in both a distressed and non-distressed scenario;

6. Reducing investment in the UK economy and impacting on the UK's World Bank Rankings.

The wider impact on lenders and the UK economy should be properly assessed before the measure is implemented. We therefore oppose the measures.

If the government intends to proceed without further assessment then to minimise the impact on lenders there should be a limit on HMRC's claims either in time or amount and a reduction or abolition of the prescribed part and transitional arrangements.

**Introduction**

HMRC has been an unsecured creditor since 2003 when its preferential status was abolished by the Enterprise Act as part of a package of reforms designed to support business rescue and encourage enterprise.

At the same time, the prescribed part was introduced as a measure that ring fenced a proportion of floating charge realisations for distribution to unsecured creditors on insolvency. The prescribed part was introduced to balance the abolition of Crown preference and to create an even distribution of assets on insolvency amongst creditors.

The government announced in the Autumn Budget that from April 2020 it intended to reinstate HMRC as a preferential creditor in respect of certain taxes. In the Budget Brief published by HM Treasury on 29 October 2018 it stated its reason for this as:

> *"From 6 April 2020, the government will change the rules so that when a business enters insolvency, more of the taxes paid in good faith by its employees and customers but held in trust by the business go to fund public services as intended, rather than being distributed to other creditors such as financial institutions"*

These measures do not propose to abolish the prescribed part and separately the government has announced proposals to increase this to £800,000[1].

When the prescribed part was introduced in 2003, lenders were able to manage this because firstly, it only affected floating charges that were entered into after the date the Enterprise Act came into force and secondly it was a known quantity, enabling lenders to assess the risk and make adequate provision.

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[1] Department of Business, Energy and Industrial Strategy: Insolvency and Corporate Governance, Government Response 26 August 2018 para 1.84

The intention to restore HMRC as a secondary preferential creditor on terms that do not restrict the level of its claims make it difficult if not impossible for lenders to assess and therefore make adequate provision for those claims.

Further, there will be an immediate impact on existing facilities if the measures are introduced in April 2020 without any transitional arrangements by causing many businesses to breach their existing facilities.

A significant amount of lending in the UK is inventory based and secured by a floating charge. It is estimated that there is at least 3 billion in outstanding floating charge lending to the SME market that will be effected if these measures are implemented in April 2020.

As a further consequence of these measures, lenders will also have to look at alternative ways to protect their future lending book, by fixed charge and personal guarantees. Fixed charges affect business growth by removing the flexibility to deal with assets which would otherwise be secured by a floating charge.

In Scotland, taking a fixed charge may not be an option at all because if the lender already has floating charge security it cannot take a fixed charge.

We therefore expect there to be less funding available for UK businesses as lenders will have to make larger provisions and/or protect lending by fixed charges (which also impacts on the flexibility of the insolvency administration regime) and an immediate impact on the viability of many businesses without transitional arrangements.

Since 2003 the UK's reputation as a place to do business has grown, with many new lenders entering the market. The UK's flexible lending market and fair insolvency regime are factors that influence entrepreneurship and drive investment. The uncertainty of recoveries on insolvency discourages investment in the UK, frustrating enterprise.

These measures have a wide impact on lenders and UK businesses damaging the UK's position in the World Bank Rankings and are at odds with reforms already announced by the government hoping to improve the UK's position[2].

UK businesses and the UK economy generally faces an uncertain future as a consequence of Brexit. The proposed timing of these measures (April 2020) would further exacerbate that.

The government should reconsider these measures following a review of the economic impact of Brexit. If the government is intent on implementing these measures, they ought to be delayed to a future date when the detrimental impact can be better absorbed by businesses.

**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?**

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[2] Department of Business, Energy and Industrial Strategy: Insolvency and Corporate Governance, Government Response 26 August 2018

Whether HMRC is restored as a secondary preferential creditor or ordinary preferential creditor makes no difference to the level of expected returns to secured creditors, the impact will be the same. However, the measures do have a significant impact on the lending market as highlighted in the introduction.

If the impact on floating charge holders, unsecured creditors and the wider UK economy have not been considered by HMRC in its impact statement, those should be evaluated before these measures are introduced.

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

We have no comments on this.

**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?**

We expect there to be additional administrative and cost burdens to businesses and lenders because of these measures.

The measures do not propose a cap either in time or amount on HMRC's claim. Prior to the Enterprise Act HMRC's preferential claims were capped at 12 months and 6 months respectively for PAYE and VAT.

HMRC's claims will also include interest and penalties and the ability of HMRC to open an enquiry into previous years returns would further increase the amount of its preferential claims.

From a lender's perspective, this makes it difficult if not impossible to assess the risk of lending, compared to the prescribed part for example, which is a set amount. This will impact the lending market in a number of ways by:

(a) making the cost of borrowing higher by increasing the cost to lender of performing a borrowing analysis;

(b) requiring greater provisioning to enable lenders to protect against the risk, which in turns reduces available funding options for businesses and impacts upon business liquidity;

(c) forces lenders to consider other forms of security such as fixed charge lending and personal guarantees which impact upon business growth and the UK insolvency regime;

(d) narrows the lending market if lenders chose not to invest in UK business because of the difficulties of assessing the level of HMRCs claim and assessing the risk.

We expect that the sectors to be hardest hit by these measures will be those which rely primarily on floating charge security including retail, the automotive industry, agriculture, construction and wholesale. There may be a reduction in lending to these and other markets and a squeeze on liquidity may see another downturn in the UK market.

The sector, which these changes are most likely to impact upon, are those companies within the 10-25 million-turnover bracket. The measures could cause a number of failures in the supplier chain as insolvency and business failures have a knock-on effect on other suppliers.

Please also refer to our comments in the introduction above.

**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 of explain why. Please suggest how we could mitigate against this.**

We believe that the measure will adversely affect administrations if there is a move away from floating charge security to fixed charge lending. The ability to place a company into administration has supported business rescue since being introduced in 2003 but the flexibility of that regime is undermined by an increase in fixed charge security because administrators cannot deal with fixed charge assets without a lender's consent.

We also believe that this will affect the viability of CVAs because a preferential creditor's debt cannot be compromised as part of that. In many cases CVAs will no longer be an option because HMRC who have historically voted on policy lines against proposals and whose claim will significantly reduce returns will likely mean that there is a move towards liquidations. More business failures have an impact on finance and future investment.

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

Yes. If these measures are introduced without any transitional arrangements, they will adversely affect existing facilities as well as new lending.

The terms of existing facilities do not take into account nor make provision for HMRC's preferential claims. If the measures are introduced as drafted this will cause many customers to enter default by breaching the terms of their facilities causing business distress and failure.

Further lenders are prejudiced because this risk has not been assessed on existing lending. Lenders will therefore suffer a greater loss than has been provided for.

The transitional arrangements which applied when the prescribed part was introduced by the Enterprise Act enabled lenders to plan and make provision for the change.

This measure would therefore prejudice lenders and other non-preferential creditors who have entered into arrangements with businesses having assessed the risk and commerciality of that arrangement based on the current order of priority.

If the government intends to implement these measures in April next year then they should only apply to floating charges entered into post 6 April 2020 to mitigate the impact on existing lending.

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

We question why HMRC require additional protection when it already has powers under existing legislation to recover unpaid tax from corporates which are underutilised.  These powers already place HMRC in a more advantageous position than most creditors.

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

We have explained in our introduction the wider impact that we expect these measures to have on the UK economy and lending to the UK market, which do not appear to have been considered in the impact statement produced by HMRC in support of these measures.

We would therefore like to see further information and evidence in support of HMRC's impact assessment and further consultation with our members before these measures are implemented.

Yours faithfully

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