Protecting Your Taxes In Insolvency
R3 response
May 2019

ABOUT R3

1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession.

2. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices. Our members have direct experience of insolvencies and their impact on individuals and businesses across the UK.

3. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession promotes economic regeneration, resolves financial distress for businesses and individuals, saves jobs, and creates the confidence and public trust which underpin trading, lending and investment.

4. We have focused this response on those questions and themes in the consultation where we can provide answers based on our members' expertise. This response is based on feedback on the proposals received from across our membership.

5. R3 would be delighted to meet HMRC officials to discuss the points raised below in greater detail. If you would like to meet us or if you have any other queries, please contact R3's Public Affairs Manager, James Jeffreys, at james.jeffreys@r3.org.uk or on 020 7566 4220.

Overview

6. We have fundamental concerns with the policy outlined in the Government's consultation ('the proposals', 'the policy', or 'Crown Preference').

7. As drafted, the policy could have a significant and negative impact on access to finance and business rescue in the UK, and will increase the impact of corporate insolvencies on pension schemes, employees, consumers, lenders, investors, and the wider business community. The full scope of the likely impact of these proposals – which is far from adequately considered in the Government's impact assessment – means there is a significant risk that long-term costs of proceeding with the policy could outweigh any gains expected by the Government.

8. There are a number of alternative policy measures the Government could pursue which would have a much more positive impact on the wider business and restructuring frameworks than the proposal in this consultation (outlined in paragraphs 12-34 and 142-146 of this response). The Government should consider implementing these alternatives instead.

9. If the Government decides to proceed with the proposals outlined in this consultation, significant revisions are required. Suggested revisions are outlined below (see paragraphs 140-141).

10. Furthermore, we are deeply disappointed in the way the Government has approached the development and introduction of this policy. There is limited available evidence to support the policy, there is limited analysis of why the Government believes it was wrong to remove tax debts' preferential status in 2002, and, up to this point, there has been no meaningful consultation on the likely impact of the policy. We are concerned that the focus of this consultation is on 'how' the policy should be introduced and not 'whether' the proposal should be introduced at all.

11. It is also disappointing that this proposal seems to be incompatible with wider government efforts to improve the UK's business rescue culture. As we have said in response to other recent government consultations, the Government must take a more holistic and coherent approach to UK insolvency and restructuring reform.

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?

12. Tax debts should be protected in some other way in the event of an insolvency.

13. Ultimately, the Government's proposals do not 'protect' tax debts. The Government's consultation does not take into proper consideration the impact of the policy on access to finance and the consequent impact on business rescue and the wider economy. As outlined below (paragraphs 107-138), the consequences of the Government's policy are likely to put taxes *at risk*.

14. There are a number of means by which the Government could better protect tax debts in insolvencies, including utilising existing powers and tools, introducing already-proposed new powers and tools, and altering HMRC's general approach to insolvency procedures and restructuring.

Existing tools

15. HMRC already has a number of tools at its disposal which it may choose to use to protect tax debts in – or ahead of – insolvencies. Effective use of these tools would negate the need to introduce the proposed policy.

16. HMRC has the power to issue Personal Liability Notices to corporate officers for a failure to pay National Insurance Contributions (NICs) or future unpaid payroll taxes[1]. HMRC also has the power to insist on upfront security deposits where there is a genuine risk of non-

[1] See Section 121C "Liability of directors etc. for company's contributions" of the Social Security Administration Act 1992, as introduced by s64 of the Social Security Act 1998 – "A Personal Liability Notice (PLN) can be issued to any individual who was acting as an officer of the body corporate at the time of the failure to pay the National Insurance contributions due under statute, and where HMRC is of the opinion that the failure to pay was attributable to the fraud or neglect by that individual. In the context of the legislation such officers are described as 'culpable officers'" – and see the Finance Act 2014 (Part 4) and the National Insurance Contributions Act 2015 (Sections 4 and Schedule 2) and Chapter 3 (reg. 97ZA–97Z) of Part 4, Income Tax (Pay As You Earn) Regulations 2003 (SI 2003/2682)

payment of Pay As You Earn (PAYE), NICs or Value Added Tax (VAT)[2]. Similarly, HMRC may issue Accelerated Payment Notices for disputed tax debts.

17. These are all powers which are not available to other creditors. Elevating tax debts to preferential status would, combined with HMRC's existing powers, put HMRC at a potentially unfair advantage over other creditor groups.

18. While we understand that HMRC may not always have the resources required to utilise its existing toolkit effectively, the Government must bear in mind that the benefits of 'preferential status' come with additional responsibilities (outlined below in paragraphs 53-56). HMRC will need to be sufficiently resourced to meet these responsibilities.

Existing proposals for additional powers

19. Alongside the proposal to elevate certain tax debts to 'preferential status', the 2018 Budget also included confirmation that the Finance Bill 2019-20 would make "directors and other persons involved in tax avoidance, evasion or phoenixism… jointly and severally liable for company tax liabilities, where there is a risk that the company may deliberately enter insolvency."[3] This proposal had previously been subject to consultation in 2018.

20. Notwithstanding R3's concerns with this second proposal (as expressed in our response to the discussion document on the measure[4] and in meetings with government officials), it represents a more acceptable means of further protecting tax debts in insolvencies than the policy outlined in this consultation. To introduce both proposals simultaneously would be excessive.

21. While the proposal to make directors jointly and severally liable for tax debts does have its drawbacks, it is at least targeted at the individuals who have put tax debts 'at risk'. By contrast, the impact of the proposal in *this* consultation will be borne by other creditors – who, like HMRC, are themselves affected by a company's failure to pay its debts.

22. Further, a more equitable means of improving returns to HMRC in insolvency procedures would be to increase the assets available to insolvent estates by improving insolvency office holders' powers to pursue debts owed to these estates (including, for example, office holders' antecedent transaction recovery powers). The more debts which can be returned to insolvent estates, the more debts can be repaid to the body of an insolvent company's creditors, including HMRC.

23. In its August 2018 response to its March 2018 Insolvency and Corporate Governance consultation, the Government said it planned to work with stakeholders to review office holders' antecedent recovery powers.[5] This project presents the Government with an opportunity to make informed proposals for improving the position of *all* creditors in insolvencies. R3 has a number of proposals for how antecedent recovery powers could be improved. We have already discussed these proposals with the Insolvency Service, and we are more than happy to discuss these with HMRC officials in further detail, too.

[2] See Paragraph 4(2)(a), Schedule 11, VATA 1994; Part 4 Income Tax (Pay As You Earn) Regulations 2003; & Part 3B, Schedule 3, Social Security (Contributions) Regulations 2001
[3] Budget 2018, Proposal 3.88
[4] 'Tax Abuse and Insolvency – R3 response', 27 June 2018
[5] "Consultation on insolvency and corporate governance: government response", 26 August 2018, pages 36-38

HMRC's approach to insolvency and restructuring

24. R3's members act as office holders in thousands of insolvency procedures every year: common feedback is that HMRC can adopt an 'uncommercial' and detached approach to insolvency procedures or restructuring efforts. This approach in itself puts tax debts at risk. To support the Government's objective of protecting tax debts in insolvencies, HMRC may wish to reassess the way it engages in insolvency procedures and restructurings.

25. There are two aspects to a revised HMRC approach to insolvency and restructuring: how HMRC manages risk prior to an insolvency, and how HMRC engages as a creditor once a company with tax debts has entered an insolvency procedure or is attempting to avoid an insolvency procedure with a consensual restructuring.

HMRC debt management

26. As a creditor – 'willing' or not – HMRC should be able to take steps to minimise the value of its debts at risk to debtor insolvencies. Indeed, HMRC is often in a better position than other creditors to know the state of a business's finances and the value of debt at risk (through HMRC's statutory powers and innovations including Real Time Information – a position which will only improve through wider take-up of the Making Tax Digital initiative). As with any other creditor, HMRC should use the information at its disposal to prevent significant tax debts from accruing.

HMRC as a creditor in insolvencies and restructurings

27. During insolvency procedures or restructurings, HMRC is commonly a key creditor. It is often owed a significant debt and, unlike other unsecured creditors, it is comparatively well-resourced, and, as an institution, it has insolvency and restructuring experience. Unfortunately, R3's members often report that HMRC does not always play a constructive role in insolvency procedures or restructuring efforts – putting at risk returns to both HMRC itself and to the wider creditor body.

28. R3 and HMRC have dedicated significant time to working together to improve office holders' experience of working with HMRC during insolvency procedures. We are grateful for HMRC's engagement on these issues, and we are pleased with the progress we have made together in many areas. We look forward to continuing this positive relationship in future, and we can attest to the commitment of HMRC staff to making improvements.

29. While there has been progress on tackling some of the 'practical challenges' of working with HMRC in insolvencies (for example, simplifying processes, and creating feedback channels to identify practical challenges as they arise), there are wider 'policy challenges' which are some way from being resolved.

30. Two key challenges are HMRC's reluctance to engage as a 'proactive' creditor in many insolvency cases or restructurings, and HMRC's apparent policy of not taking a 'commercial' approach in these situations.

31. R3's members report that, despite its position, HMRC can often be a 'passive' creditor, and it does not always support efforts to make an insolvency procedure as effective as possible; as a result, HMRC can pose an avoidable risk to rescue. For example, members have reported that HMRC's lack of engagement can stymie other creditors' efforts to appoint an insolvency

practitioner to take over as the office holder from the Official Receiver, even where an insolvency practitioner's skills and expertise could improve returns to *all* creditors – including HMRC itself.

32. Our members also report that HMRC's lack of 'commerciality' can put tax debts at risk. This is supported by 2018 research into Company Voluntary Arrangements (CVAs)[6], carried out by the University of Wolverhampton and Aston University on behalf of R3, which found that:

    a. Unsecured creditors are critical of HMRC's involvement in CVAs, with feedback being that "HMRC often does not take part in early negotiations as to what terms the proposal should take but instead comes in at the last moment with significant amendments. If those amendments are not agreed, HMRC will vote against the proposal."[7]

    b. Insolvency practitioners feel there is an inconsistency in HMRC's approach to CVAs: "sometimes HRMC [is] passive, sometimes it [is] active."[8]

    c. "There is a general belief that HMRC votes based upon policy grounds rather than purely commercial grounds."[9] This can mean HMRC rejects – or does not support – CVAs which promise a higher return on tax debts than would be possible in administration or liquidation – the alternative for insolvent companies when CVAs are rejected.

33. The research report recommended that public sector creditors should have to explain their decision fully if they refuse to support a CVA proposal[10]. This would help companies put together alternative proposals.

34. Were HMRC to take a more 'commercial' approach to business rescue, tax losses in insolvencies would be reduced.

Secondary preferential creditor status

35. If HMRC is to be a preferential creditor, it should be a secondary – or even tertiary – preferential creditor. There is no compelling argument to promote tax debts to preferential status, let alone for tax debts to be repaid at the expense of unpaid wages owed to employees or ring-fenced savers. These creditors enjoy preferential status because they may be put into a vulnerable position by the insolvency of their employer or financial institution.

Question 2

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

36. For the most part, the taxes intended to be included in this measure would not cause challenges for insolvency office holders beyond those which already exist when processing HMRC claims.

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[6] "Company Voluntary Arrangements: Evaluating Success and Failure" Professor Peter Walton, Dr Lezelle Jacobs, Chris Umfreville, (commissioned by R3; sponsored by ICAEW), May 2018
[7] Company Voluntary Arrangements: Evaluating Success and Failure, page 63
[8] Company Voluntary Arrangements: Evaluating Success and Failure, page 64
[9] Company Voluntary Arrangements: Evaluating Success and Failure, page 64
[10] Company Voluntary Arrangements: Evaluating Success and Failure, page 4

37. These challenges are typically practical in nature and are often linked to delays in HMRC administrative processes, including, for example, delays to VAT approvals, final clearance (that agreed debts have been paid), or the calculation of penalties and interest.

38. Given that our members report that HMRC administrative delays can *already* hold up the closure of insolvency cases, the promotion of tax debts to preferential status could compound delays, as preferential tax debts will need to be paid before money is returned to unsecured creditors. Delays in finalising these payments with HMRC will therefore delay repayments to unsecured creditors (whereas, currently, HMRC payments are made concurrently with payments to other unsecured creditors). Delays will also add to the costs of insolvency processes: office holders unable to close cases will incur costs in continuing to fulfil their statutory obligations.

39. In 2015, the Government committed itself to improving the UK's standing in the World Bank's 'Doing Business' rankings.[11] Although this may not be an objective of the current administration, it is worth noting that HMRC-related administrative delays in insolvency procedures could harm the UK's World Bank ranking: the World Bank assesses business frameworks on the speed at which insolvency procedures are concluded, and the cost of concluding cases. The Government's policy would slow down case resolution and push up the cost of insolvency.

40. It is also worth noting that the promotion of penalties to preferential status could be a particular source of delays. At present, these 'debts' are unproven. These penalties can be disputed by office holders, and agreeing penalties owed can involve significant time and work, or even recourse to the courts (see paragraphs 58-64 for more detail).

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?

41. We foresee significant administrative burdens falling upon individuals, businesses, insolvency practitioners and others, including HMRC, as a result of this measure.

42. There will be two areas where additional administrative burdens will be especially notable: the impact on floating charge lenders and the businesses in receipt of this lending; and the impact on insolvency processes, the office holder, and key creditors.

The impact on lenders and debtors

43. Among the many problems with the proposed policy, the following two issues are among the most concerning: the policy will be retrospective in the sense that, once introduced, HMRC's preferential status will outrank pre-existing lending and other debts; and, unlike the earlier iteration of 'Crown Preference', there will be no 'cap' on the age of tax debts qualifying for preferential status. These two features of the policy will have a number of consequences.

44. Having extended loans on the basis that floating charge debts occupy a relatively high position in the insolvency order of priority, and having priced the cost and risk of this lending

[11] The Conservative Party Manifesto 2015, Page 17

accordingly, floating charge lenders will now find these calculations completely undermined. From 6 April 2020, existing floating charge debts will essentially become as risky as unsecured debts. Lenders' balance sheets will have to register a zero value for outstanding floating charge loans in case of insolvency. If the Government were to proceed with this policy, we would not be surprised to see a spike in statutory insolvency procedures in the weeks leading up to 6 April 2020, driven by floating charge lenders seeking to avoid the impact of 'Crown Preference'.

45. To adapt to this unexpected change in the risk and value of outstanding debts, lenders will need to undertake a detailed historic and ongoing review of the tax positions of the companies to whom they have extended loans, in order to check for tax debts and penalties and ascertain the risk to their capital. Lenders may also seek insurance or make significant provisions to cover the risk to capital presented by 'Crown Preference'.

46. Given there will be no 'cap' on the age of tax debts which may now outrank their claims, the lenders' reviews will have to look back through potentially decades of financial records. This will be a significant undertaking.

47. While there do not appear to be readily available statistics on the scale of floating charge lending in the UK, this form of lending is known to be widespread. This adds to the size of the administrative task required to review the status of outstanding loans, and will mean a significant amount of capital will be affected by the Government's proposal.

48. The Government's consultation makes reference to the value of SME lending totalling £57bn up to the end of July 2018. This figure is not a meaningful stand-in for floating charge lending. While the value of outstanding floating charge lending is likely to be much lower in value than £57bn, it does play a disproportionate role in supporting UK SMEs generally and larger businesses in specific sectors. Any challenge to the attractiveness of floating charge lending will therefore have a correspondingly disproportionate impact on those businesses which rely on it. We would recommend the Government speak to the banks, other lenders, and representatives of the financial services sector, such as UK Finance, for a clearer picture of the scale of floating charge lending in the UK. The impact of the Government's policy on UK access to finance is discussed in more detail in paragraphs 107-112.

49. The administrative impact of the Government's policy will not be a one-off either: any lender extending finance on a floating charge basis beyond 6 April 2020 will be required to conduct an ongoing review of its debtors' tax positions.

50. The need for additional insurance or provisions and the need to carry out historic and ongoing reviews of debtors' tax positions – involving reviews of tens of thousands of businesses – will create significant costs and administrative burdens for lenders. These costs may well be passed on to debtors, increasing the cost of business finance; alternatively, lenders may simply offer fewer loans (see paragraphs 107-138).

51. The Government should seek to ameliorate the impact of its proposal by limiting the age of tax debts which would qualify for preferential status. We recommend a cap of six months (as was the case with some taxes under the pre-Enterprise Act 2002 framework). Doing so would provide lenders with much more certainty about the potential size of a preferential claim, and would significantly reduce the scope of any historic or ongoing reviews which may need to be undertaken.

52. Additionally, the Government should amend its proposal so that tax debts which arise before 6 April 2020 should not qualify for preferential status after 6 April 2020. This would remove the need for lenders and others to carry out an in-depth review of debtors' finances ahead of the introduction of the policy, significantly reducing the administrative burden which could be created by the proposals.

The impact on insolvency procedures

53. The Government's proposed policy will create additional administrative burdens for office holders and for HMRC.

54. As a preferential creditor, HMRC will have a number of additional responsibilities to fulfil. If HMRC is not sufficiently resourced to fulfil these responsibilities, insolvency procedures will grind to a halt. As outlined in paragraph 38, the longer insolvency cases are open, the higher the costs of resolving insolvency. If HMRC does not fulfil its responsibilities, office holders will be compelled to apply to the courts for direction. This will add further delays and costs to insolvency procedures.

55. Preferential creditors' responsibilities include (but are not limited to) discharging administrators of their liability[12], approving the extension of administrators' terms,[13] and approving administrators' fees in the absence of a creditors' committee (or if the creditors' committee is unable to come to an agreement)[14].

56. The impact of a preferential creditor not fulfilling its obligations can be illustrated with reference to the government's Redundancy Payments Service (RPS). In the existing framework, the RPS will generally cover debts owed to employees, and it will then take their place as a creditor (either as a preferential or unsecured creditor, depending on the type of debt being reclaimed). In 2018, R3's members reported that the RPS appeared to have taken a policy decision to stop voting in insolvency procedures because of resource constraints. This caused severe disruption in insolvency procedures, which continued until feedback was passed to the RPS by R3, and voting resumed. Without sufficient resourcing for HMRC, there is a real risk that these problems could become much more common in insolvency procedures.

57. Even assuming HMRC does fulfil its obligations, having to work with an additional preferential creditor may create additional administrative burdens for office holders.

The impact on insolvency procedures – tax penalties, interest and other unproven debts

58. The elevation of tax penalties to preferential status will potentially be a significant driver of additional work for office holders.

59. Agreeing the value of penalties and interest – and even whether penalties or interest are owed – will create a significant amount of additional work and expense. In many cases, the accounting and tax records of distressed and insolvent entities are incomplete. In such circumstances, it is HMRC policy to raise an assessment of the liability they estimate is owed to them, and where relevant, penalties. Where such an assessment would rank as

[12] Paragraph 98 of Schedule B1 of the Insolvency Act 1986 – 'Vacation of office: discharge from liability'
[13] Paragraph 76 of Schedule B1 of the Insolvency Act 1986 'Automatic end of administration'
[14] Rule 18.18 of the Insolvency (England & Wales) Rules 2016 – 'Remuneration: procedure for initial determination in an administration'

unsecured, the office holder's decision whether to spend time reviewing and if necessary contesting the assessment is usually based upon whether there is a dividend available to unsecured creditors. If penalties and interest are elevated to preferential status, office holders will have to spend a significant amount of time in *every* case establishing whether any penalties or interest are owed, and they will have to decide whether or not to challenge these claims (which would incur further costs). This work will have to be completed before distributions to floating charge and unsecured creditors are made, and will further deplete the value of floating charge and unsecured creditor returns: the costs of insolvency procedures will increase, eating into available funds, while more money from an insolvent company's assets, otherwise available to subordinate creditors, will be diverted to preferential creditors.

60. The impact would be especially unfair if an office holder *successfully* disputes a tax penalty: having demanded payment of a penalty without foundation, HMRC would essentially have wasted other creditors' money by forcing the office holder to spend time on a challenge.

61. It is also difficult to understand the argument for establishing tax penalties and interest as preferential debts in the context of the Government's own justification for its policy proposal. The Government says that it "has decided that when a business enters insolvency, more of the taxes paid in good faith by its employees and customers should go to fund public services as intended."[15] Tax penalties and interest are clearly not "taxes paid in good faith by… employees and customers".

62. For these reasons, it is imperative that tax penalties and interest remain unsecured debts: their elevation to a preferential claim is illogical and arbitrary, and would compound the problems created by the proposed policy.

63. There is also a danger that the elevation of penalties and interest to preferential status could create a perverse incentive for HMRC to apply additional penalties in cases where it does not currently do so.

64. If the Government does wish to elevate tax penalties to preferential status, it is important that the Government also introduces means to limit the cost impact on insolvency procedures. One option would be to deduct the costs of assessing or challenging penalties from the dividend due to be paid to HMRC.

Other administrative burdens

65. The fact that not all tax debts will be elevated to preferential status could potentially create administrative burdens for office holders, as they will have to assess which tax debts are preferred and which are unsecured.

66. While the consultation references some specific tax debts and makes reference to penalties and interest, it is unclear how a number of other tax debts will be treated. Of particular concern are 'abnormal' tax debts, including Accelerated Payment Notices, 'follower notices', and disguised remuneration charges. Elevating these debts to preferential status would create the same problems with elevating penalties and interest (as outlined above). These debts should remain an unsecured debt.

[15] Protecting Your Taxes in Insolvency', February 2019, page 4

67. If the Government is to proceed with its proposals, it will need to produce a definitive list of the tax debts which qualify for preferential status.

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.

68. The Government's proposal will have a significant impact on the insolvency framework's existing rescue procedures: administration and the CVA.

69. The proposal will make it harder to rescue businesses out of administration, and it will decrease the likelihood of creditors approving CVAs (consequently pushing more insolvent companies into administration or liquidation, and reducing the value of creditor returns).

70. The proposal poses a fundamental threat to business rescue in the UK, with wider implications for the economy and the Government's tax receipts. The obvious path for mitigation is for the Government not to proceed with its proposed policy. Short of not proceeding with the proposed policy, the Government must make significant alterations to its policy. R3's suggested alterations are outlined in paragraphs 140-141, and we outline the wider implications of the Government's policy on business rescue and access to finance in paragraphs 107-138.

Impact on administration

71. There are three statutory purposes to administration:

    a. Rescuing the company as a going concern, or

    b. Achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or

    c. Realising property in order to make a distribution to one or more secured or preferential creditors.

72. The Government's policy poses a clear threat to objectives (a) and (b) (NB. objective (b) is often achieved by selling parts of a company's business as a going concern).

73. The availability of fresh funding to support a restructuring is a fundamental feature of many business rescues achieved through administration. Often, this funding is provided on a floating charge basis, a flexible and popular form of finance, particularly in rescue situations.

74. The introduction of the Government's policy is likely to have an impact on the availability of floating charge lending from 6 April 2020 – if not long before. As outlined above, the Government's policy will render floating charge lending as risky as unsecured lending. As a result, floating charge facilities will either not be offered, or they will become prohibitively expensive. This will be particularly acute in rescue situations, where the risk to capital is increased. Restricted access to finance in rescue situations will result in more business failures.

75. In a survey of R3 members, concluded in April 2019, we found that 78% of respondents believed that the Government's proposal will make it harder to rescue businesses. Over half (51%) of respondents felt that the proposal would make it *much* harder to rescue businesses[16].

76. We also asked survey respondents to estimate a) the number of businesses they had rescued in the preceding 12 months, and b) the number of businesses they feel they would not have been able to rescue if the Government's proposal had already been introduced. On average, respondents said they had rescued 8.6 businesses in the past 12 months; on average, respondents said that 43% of these businesses would not have been rescued if the Government's policy had already been introduced[17].

77. 83% of respondents felt that the Government's proposal would make it harder for businesses to access new finance, including 52% of respondents who felt that the proposal would make it *much* harder to do so.

Impact on CVAs

78. R3's members have expressed concern that the Government's policy will significantly reduce the chances of CVAs being approved.

79. The Government's proposal will significantly reduce the returns to non-preferential unsecured creditors in insolvency procedures. As a result, non-preferential unsecured creditors will have little incentive to support CVA proposals. In response to R3's member survey, members gave the following examples of how the Government's policy would have affected recent cases:

    a. "*A large CVA involved a million-pound turnover company and a large level of debt to HMRC for PAYE, NIC and VAT. The CVA was approved by unsecured creditors, with the intention of achieving a 40p in the £ return, with a 'bullet payment' from another company wishing to purchase the business. This included the transfer of 60 employees, securing their future employment. If the Government proposal was in place, the return in the CVA to unsecured creditors would have been nil. The CVA would have likely been rejected by creditors. This could have resulted in 60 job losses in a small community.*"

    b. "*Having just reviewed two CVAs on which I was recently appointed, I have doubts that either would have been approved in the event that HMRC held preferential status. While HMRC would have been likely to have been repaid in full, the consequence of Crown Preference would be that it would diminish the return to unsecured creditors so much that it would have made it unlikely that the CVA would have been accepted. This would lead to inevitable liquidation with a much lower return to everyone involved.*"

80. As outlined above, and in paragraph 32, the alternatives to CVAs are administration and liquidation. Both of these procedures are likely to be less beneficial for stakeholders as a whole – including HMRC – than a CVA.[18]

[16] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents
[17] R3 Member Survey, 7 March 2019 – 23 April 2019, 61 respondents
[18] See Company Voluntary Arrangements: Evaluating Success and Failure

81. The wider impact of increased business failure is discussed in paragraphs 107-138.

Question 5

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

82. Yes. As outlined in paragraphs 43-52, the decision to allow some tax debts to take priority over existing lending will create significant problems for those who have already lent on a floating charge basis: this lending would have been based on the assumption that HMRC debt is unsecured (unsecured creditors have also traded with companies based on the same assumption). There is a strong argument that the Government's approach is unfair and arbitrary.

83. Again, the most obvious means of avoiding harm is to not proceed with this policy in its entirety.

84. Short of this, the Government should follow the precedent set with the restrictions placed on administrative receivership by the Enterprise Act 2002 (EA2002). This Act restricted secured creditors' rights to appoint administrative receivers, but this restriction was only applied to charges created after the Act's introduction: lenders whose charges pre-dated the Act were allowed to continue to exercise their pre-Act rights (almost two decades since the passing of the EA2002, there was one administrative receivership in 2018[19]).

85. The restrictions on administrative receivership are clearly analogous to the re-introduction of 'Crown Preference': post hoc government legislation fundamentally changed the risk profile of a loan. In the case of administrative receivership, the Government appeared to recognise that this was unfair.

86. Given the above, the Government should, at the very least, amend its policy so that floating charges created before 6 April 2020 should continue to be repaid in priority to HMRC's preferential debts. As well as being fair to other creditors, this approach would help avoid some of the potentially significant administrative burdens created by the currently 'retrospective' nature of this policy (as outlined in paragraphs 43-52).

87. On a similar basis, as stated in paragraph 52, the Government should take the same approach to tax debts: any tax debts which arise before 6 April 2020 should not qualify for preferential status post-6 April 2020.

88. We welcome the fact that the Government is proposing that the policy will only apply to insolvency cases which begin after 6 April 2020. It is imperative that this remains the case: office holders require certainty that 'Crown Preference' will only apply to future cases. Without this certainty, office holders will be reluctant to declare any distributions – to preferential, unsecured, or floating charge creditors – in existing cases until the policy is introduced.

89. Further, without such certainty, it would be very difficult to propose Voluntary Arrangements prior to the provisions coming into force, as the proposed recovery prospects of each class of creditor would remain uncertain. For this reason also, the transitional

[19] Insolvency Service, Corporate Insolvency Statistics, January to March 2019, published 30 April 2019

provisions should ensure that 'Crown Preference' applies only in relation to Nominee appointments commenced after the implementation date (rather than defining the cut-off date as the Voluntary Arrangement approval date), as companies and debtors must be able to make Voluntary Arrangement proposals on the basis of the existing creditor priorities, rather than be required to predict the date on which their proposals may be approved by creditors.

Question 6

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

90. Based on the information provided by the Government in its consultation document,[20] its Budget policy costings document,[21] and its 'Budget Brief' on the policy,[22] it appears that far too few considerations or potential impacts have been taken into account in proposing this policy.

91. The Government's backing for this policy appears to be based on a very narrow, static analysis of expected additional tax receipts through insolvency procedures. Any assessment of the impact of such a significant policy decision must be much more dynamic. As the Government noted in its assessment of the policy costings in the October 2018 Budget, the "main area" of uncertainty with the impact of this policy is "the behavioural response" to it. The 'behavioural response' to this policy may well be significant and is central to our fundamental concerns with the Government's proposals. Unfortunately, the 'behavioural response' to the proposed policy does not seem to have been taken into account by the Government.

92. While the Government outlines a relatively small, short-term gain from the policy, we feel there is a substantial risk that this projected gain will be outweighed by significant long-term costs. These potential costs must be taken into account.

93. Potential costs include, but are not limited to: reduced access to finance; reduced creditor engagement in insolvency procedures; reduced confidence in the UK's insolvency and restructuring framework, and consequently reduced confidence in the wider economy; reduced chances of business rescue; reduced tax returns; an increased impact of corporate insolvencies on other businesses, employees, consumers, and pension schemes; and higher costs for Government associated with increased business failure.

94. 75% of the respondents to R3's member survey strongly or slightly disagreed with the Government's assessment of its likely impact, including 53% who strongly disagreed with the assessment. Just 12% agreed with the Government's assessment. Perhaps unsurprisingly, therefore, 83% of respondents to the survey disagreed with the Government's proposal, including 67% who strongly disagreed.[23]

95. In addition to the above, the proposals in this consultation are incompatible with the objectives of other recent government policy proposals.

[20] 'Protecting Your Taxes In Insolvency'
[21] 'Budget 2018: Policy Costings', page 36
[22] 'Protecting Your Taxes In Insolvency: Budget 2018'
[23] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents

The Enterprise Act 2002 and the justification for change

96. Before considering the wider implications of this proposal beyond those set out in the consultation, it is worth considering why the Government ended the preferential status of tax debts in 2002. Despite some superficial differences between the pre-EA2002 policy and the proposed policy, the two are essentially the same.

97. The Government's reasoning for removing preferential status for tax debts is outlined in the 2001 White Paper, 'Productivity and Enterprise: Insolvency – A Second Chance' ('the 2001 White Paper'):

> "*Finally, as an important and integral part of this package of measures, we will proceed with the abolition of Crown preference in all insolvencies. Preferential claims in insolvency originated in the late 19th century, but in recent years the trend in other jurisdictions has been towards restricting or abolishing Crown or State preference as, for instance, in Germany and Australia. We believe that this is more equitable. Where there is no floating charge-holder, the benefit of abolition will be available for the unsecured creditors. Where there is a floating charge-holder (in relation to a floating charge created after the coming into force of the legislation), we would ensure that the benefit of the abolition of preferential status goes to unsecured creditors. We will achieve this through a mechanism that ringfences a proportion of the funds generated by the floating charge.*"[24]

98. It is not clear why this analysis no longer holds water for the Government.

99. It is also worth noting that the Government has taken an apparently inconsistent approach to the relative merits of improving the status of taxes paid by "customers" compared to the merits of similar unsecured debts.

100. At the heart of the argument for promoting some tax debts to preferential status is the Government's belief that "taxes paid in good faith by its employees and customers should go to fund public services as intended, rather than being distributed to other creditors"[25]. While an admirable sentiment, the same argument could be made for any and all debts in insolvency procedures: creditors have extended credit in good faith. Insolvency procedures are there to balance competing claims in the interests of the wider economy.

101. Particularly pertinent here is the treatment of debts owed to consumers – the same 'customers' referred to in the Government's consultation. There are many situations where consumers will make a payment for a good or service 'in good faith' and the expectation that the transaction will be later completed. This includes situations where consumers have paid a 'pre-payment' or deposit for a good or service.

102. In 2016, having examined the impact of retail insolvencies on consumers, the Law Commission recommended that a limited group of consumer claims, including pre-

[24] Productivity and Enterprise: Insolvency – A Second Chance, July 2001, paragraph 2.19, page 12
[25] 'Protecting Your Taxes in Insolvency', February 2019, page 4

payments, be paid in advance of floating charge holders in insolvency procedures[26]. In response to the Law Commission's recommendations, the Government said, in December 2018 (after the proposals covered by this consultation had been announced), that:

> "*The government recognises the concerns when individual consumers may lose money in an insolvency situation. However, in its view this recommendation could increase the cost of capital, harm enterprise and lead to calls for preferential status for other groups of creditors which would adversely affect the amount available to other unsecured creditors, which would lead to far greater losses to the wider economy. The Law Commission suggest that there are value judgments to [be] made when considering the insolvency hierarchy and set the measure out as an option should the government feel the need to act. The government has decided not to pursue this measure.*"[27]

103. Given that the Government accepts that giving one set of consumer claims priority status in insolvencies would "increase the cost of capital, harm enterprise and lead to calls for preferential status for other groups of creditors which would adversely affect the amount available to other unsecured creditors, which would lead to far greater losses to the wider economy," it is unclear why the Government has not applied its own reasoning to consumers' and employees' tax payments.

104. While R3 members are not entirely unsympathetic to the idea that tax debts might be deserving of special treatment, the response to our member survey was unequivocal: 61% of respondents felt that there is no more compelling justification for moving tax debts up the order priority than there would be for moving other unsecured debts. 26% of respondents were sympathetic to tax debts being moved up the order, while 12% thought that other unsecured creditors have more of a claim than HMRC to be moved up the order.[28]

105. 85% of respondents to the R3 survey felt that the negative impact the proposals would outweigh the Government's justification for introducing the change.[29]

106. In the 2018 Budget 'Red Book', the Government says that the aim of the policy is that "from 6 April 2020, when a business enters insolvency, more of the taxes paid in good faith by its employees and customers, and temporarily held in trust by the business, will go to fund public services rather than being distributed to other creditors."[30] It is worth noting that money cannot be held 'in trust' unless a trust has actually been set up for that money.

The impact on access to finance

107. As outlined above, a significant 'behavioural response' may well be a restriction on access to finance for UK businesses, at least on a floating charge basis.

108. As stated in paragraphs 71-77, this could make it more difficult to rescue businesses (the consequences of which are outlined in paragraphs 123-126).

[26] 'Consumer Prepayments on Retailer insolvency', Law Commission, July 2016
[27] 'Law Commission Report on Consumer Prepayments on retailer insolvency: government response', December 2018, page 17
[28] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents
[29] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents
[30] Budget 2018, Proposal 3.87

109. The impact of the increased risk of lending on a floating charge basis will not just be felt by insolvent businesses, but by solvent businesses, too.

110. While floating charge lending supports businesses across the economy, some sectors rely on it more than others. Our members report that floating charge lending is particularly valued by smaller businesses, by growing businesses, and by retailers, who see floating charge lending as a cost-effective means of funding stock expansion. Floating charge lending is particularly helpful for businesses which do not have assets available which would be suitable for a fixed charge; stock or intangible assets may be all some businesses have to offer as security, and taking out a floating charge may therefore be their only option.

111. At an R3 roundtable held to discuss the Government's proposals,[31] lenders repeatedly noted the fact that the policy would force them to restrict access to finance. One attendee, representing a lender, said that businesses not yet 'maxing out' their loan facilities would be denied additional lending to fund capital expenditure. On the other hand, businesses which are 'maxing out' their loan facilities would be pushed into default as the lender would have to adjust facilities to take into account the risk to its capital posed by the Government's policy. The attendee added that the policy would turn some of the lender's 'good book' debtors into 'bad book' debtors.

112. A restriction on access to finance – whether in terms of the options available or in terms of the cost of lending – will restrict businesses' ability to grow and to cope with economic challenges. Lower business growth means lower tax receipts for the Government. And, with restrictions imposed on solvent businesses' means of adapting to external shocks, insolvency risks across the economy will increase.

The impact on the insolvency framework

113. The insolvency and restructuring framework creates the confidence and public trust which underpins trading, lending, and investment in the UK economy. When a company cannot pay its debts in full, the insolvency framework acts as an insurance mechanism: it reduces the impact of an insolvency on the wider economy, and lessens the risks of doing business. It does this by offering the prospect of rescue, where possible, and by fairly apportioning the impact of insolvency where rescue is not an option.

114. The Government's proposal will limit the number of stakeholders who benefit from the insurance provided by the UK's insolvency and restructuring framework – essentially just to fixed charge creditors and HMRC. Consumers, trade creditors, pension schemes and all other unsecured creditors will be left out.

115. Although the proposal will see a limited number of tax debts promoted to preferential status, in practice, it is these tax debts which account for the bulk of the total funds owed to HMRC.

116. As part of R3's survey, we asked respondents to outline how returns to unsecured creditors would be affected if the Government's proposal was already in place. Responses included:

[31] The roundtable took place on 14 May 2019 under the Chatham House rule. HMRC was in attendance.

a. "*Of the dividends paid in the last 12 months, a significant amount would not have been paid to the unsecured creditors if the Government's proposal had been introduced: all funds would have been returned to HMRC.*"

b. "*In one recent case, there was cash at bank of £50,000. Immediately upon appointment, we notified unsecured creditors that we intended to pay a dividend, and paid 10p in £ back within a few months. If the Government's proposal was implemented, then there would have been no unsecured dividend: the HMRC claim was for VAT and PAYE debts worth £36,000.*"

c. "*I am currently working on a case where we will shortly be paying a dividend of approx. 40p in the £ to all unsecured creditors, including HMRC. HMRC accounts for approximately 50% of the total unsecured debt. If the proposal was in place we would just be paying HMRC under their preferential status. In a second case, we have recently issued a Notice of Intended Dividend which equates to a dividend of approx. 10p in the £. If the proposal was in place now, all funds would go to HMRC. Unsecured creditors would receive nothing.*"

d. "*In one case I have, I am distributing 10-15% to unsecured creditors of which HMRC will receive the lion's share of the distribution. Under the proposed changes, HMRC will not receive much more, but unsecured creditors will receive nothing. This will affect the smaller businesses which have already lost significant cash flow from the insolvency.*"

117. The consequences of lower – often nil – returns for unsecured creditors includes a loss of confidence in the insolvency and restructuring framework, and an increased risk of an insolvency 'domino effect'.

The impact on the insolvency framework – confidence

118. The prospect of nil returns from insolvency procedures will hurt unsecured creditors' confidence in the insolvency framework, undermining confidence in doing business and in the wider economy (with a consequent impact on business growth and future tax receipts).

119. A lack of confidence in the insolvency framework is likely to have a deleterious impact on creditor engagement in insolvency procedures: with limited likelihood of seeing anything out of an insolvency procedure, there is no incentive for unsecured creditors to engage. 84% of respondents to R3's member survey said that the proposal will have a negative impact on creditor engagement in insolvency procedures, including 66% who said the proposals will have a *very* negative impact.[32]

120. Creditor engagement is vital in insolvency procedures: it supports the smooth and efficient running of cases, and can help office holders identify examples of director misconduct or the existence of previously unknown assets which can be used to repay the creditor body. Undermining creditor engagement will undermine the effectiveness of the UK's insolvency and restructuring framework. R3 members already report problems in getting unsecured creditors engaged in insolvency procedures; the Government's proposal threatens to make matters worse.

[32] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents

The impact on the insolvency framework – the 'domino' effect

121. The impact of one company's insolvency on others – including customers and suppliers – can be significant. An R3 survey of UK businesses in spring 2018 found that 26% of respondents had "suffered a hit to their finances following the insolvency of a customer, supplier or debtor in the [previous] six months".[33] R3 members have also referred to an insolvency 'domino effect' whereby the insolvency of one company causes the insolvency of others. When R3 surveyed members on the 'domino effect' in 2016, respondents said that the failure of a supplier or customer was the primary or major factor in 20% of cases in the preceding 12 months.[34]

122. Although unsecured creditors are already unlikely to see significant returns in insolvency procedures, the increased likelihood of creditors seeing nothing back at all is likely to exacerbate the 'domino effect'. Again, this will have consequences for economic growth – and government tax receipts. More failing businesses means fewer taxes generated by a growing economy.

The impact on business rescue

123. A core objective of an insolvency framework is to manage the orderly wind-down of unproductive and poorly performing businesses so that their assets, ideas, and employees may be re-used more productively elsewhere in the economy.

124. However, it has long been recognised that, where beneficial, rescue should be preferred to closure. Rescue minimises the disruption caused by insolvencies: it protects creditor value, protects jobs, limits the 'domino effect', and gives viable businesses a second chance.

125. The importance of business rescue has long been a central tenet of government insolvency and restructuring policy in the UK. Indeed, in August 2018, the Government outlined proposals for a number of new business rescue procedures.[35] The threat to business rescue posed by the proposal in *this* consultation undermines wider government efforts to promote business rescue.

126. Increased, avoidable business failure is not a positive for government finances. On the one hand, a failure to rescue a potentially viable business will deprive government of future tax receipts from the failed business (and will limit the tax receipts from those businesses adversely affected by the failure). On the other hand, failure leads to increased government costs: redundancy pay and unemployment benefits for affected staff will have to be covered.

Timing

127. Given the above, the Government should consider carefully the timing of introducing its proposal. Notwithstanding the fact that the proposal itself may cause a spike in insolvency numbers (see paragraphs 44 and 111), it is worth noting that many in the

[33] Research undertaken by BDRC. Questions were put to 1,200 UK businesses via BDRC's monthly Business Opinion Omnibus. Online interviews with a nationally representative sample of senior financial decision makers across the UK, weighted by size, region and sector. Fieldwork dates 29 March to 18 April 2018.
[34] R3 Member Survey, 2 June 2016 – 14 June 2016, 208 responses
[35] 'Consultation on insolvency and corporate governance: government response', August 2018

insolvency and restructuring profession have concerns about the health of the economy in the near-term: underlying corporate insolvency numbers are already rising (having increased 10% from 2017 to 2018; the first annual increase since 2011)[36] and R3 members have expressed concern about the impact on the economy of the UK's departure from the EU, particularly if the UK were to leave without a deal. Given the proposed policy's likely negative impact on UK businesses' ability to grow and withstand economic shocks, and the negative impact the policy may have on UK business rescue, the Government may wish to delay the introduction of this policy until there is a less challenging economic environment.

'The Prescribed Part'

128. As stated in the Government's 2001 White Paper, the removal of 'Crown Preference' was accompanied by the introduction of a 'prescribed part' to ensure that additional funds were available to unsecured creditors as well as floating charge holders (see paragraph 97).

129. In August 2018, the Government announced plans to increase the prescribed part to £800,000 (from £600,000).[37]

130. Despite the link between 'Crown Preference' and the prescribed part, the impact of reintroducing 'Crown Preference' on the prescribed part does not appear to have been considered by the Government. This needs to be addressed.

131. While R3 supported the Government's plans to increase the prescribed part (this is something we had called for), this might need to be reconsidered given the 'squeeze' the combination of an increased prescribed part and a renewed 'Crown Preference' will place on floating charge lending.

Scotland

132. The Government's proposal fails to take into account crucial differences between the corporate framework in Scotland and the framework in England and Wales. As a result, the Government's proposal is likely to have a more acute impact in Scotland.

133. The underlying issue is that Scots law on secured lending is much less flexible than English and Welsh law. While lending in England and Wales may be able to adapt in some way to the Government's proposals, the same would not be possible in Scotland.

134. In England and Wales, the law recognises the possibility of obtaining fixed charge security over virtually any class of asset; Scots law does not. In commercial finance spheres, this translates most notably in England and Wales to (a) plant and machinery ('chattels' in England and Wales, and 'corporeal moveables' in Scotland) and (b) trade debts. Chattel mortgages and invoice financing or factoring are consequently common-place forms of commercial secured lending in England and Wales.

135. Scots law has no such thing as a 'chattel mortgage', and so businesses in Scotland cannot leverage the value of their plant and machinery to access finance to the same degree as businesses in England.

[36] Insolvency Service, Company Insolvency Statistics, January to March 2019, published 30 April 2019
[37] 'Consultation on insolvency and corporate governance: government response', August 2018

Other behavioural changes

136. The above paragraphs only begin to scratch the surface of potential 'behavioural responses' to the Government's proposals; there are many more ways in which the proposal could have unintended consequences or create perverse incentives. For example, tax debts may themselves be leapfrogged by lenders shifting from floating charge lending to fixed charge lending. This would undermine the expected returns of the policy outlined in the consultation document.

137. This does not necessarily mean that the negative impact of the proposal on access to finance will be avoided: lending on a fixed charge basis can be more expensive than doing so on a floating charge basis. For example, a fixed charge secured against a company's plant and machinery would require the lender to review the status of that plant and machinery much more frequently than they would have to if the loan were secured against a floating charge. Not all lenders will be able to lend on a fixed charge basis, either, while not all businesses will be able to borrow on a fixed charge.

138. Lenders may also switch to demanding personal guarantees from directors as additional security. This would undermine the principle of limited liability in the UK, and would undermine successive governments' attempts to foster an entrepreneurial culture in the UK.

Question 7

Do you have any comments on the assessment of equality or other impacts?

139. We have no particular comments on the assessment of equality impacts. Our views on the wider impact of the policy are outlined above. To reiterate, we feel that the Government's impact assessment is far too narrow and that it significantly underestimates the – negative – impact that the policy will have on the UK economy.

Amending the proposal

140. As stated throughout this response, we would urge the Government to reconsider its proposals. The best means of limiting the negative impact of the policy would be to not proceed with introducing it. We believe that the benefits of the proposal, as outlined in the Government's consultation, would be outweighed by a number of significant long-term costs. Far from protecting taxes in insolvency, the proposals will put taxes at risk.

141. If the Government is determined to proceed, a number of alterations to the policy are required, some of which have been outlined above. In summary, we would recommend the following amendments and considerations:

  a. The age of tax debts which are eligible for preferential status should be capped, as they were under the pre-EA2002 iteration of 'Crown Preference'. If preferential status were limited to (the specified) tax debts which arose only in the six months prior to an insolvency, it would help ameliorate the administrative burden of monitoring debtor companies' tax positions, and would provide lenders, debtors, office holders and other creditors with a much clearer idea of the value of a preferential claim.

b. Floating charges should still be repaid in preference to preferential tax debts if the charge was created before 6 April 2020. While this would not lessen the impact of the policy on access to finance from April 2020, it would lower the administrative burden the policy would impose on existing floating charge lenders and debtor companies, and would be a fairer approach to take.

c. Only tax debts arising after 6 April 2020 should qualify for preferential status. This would lower the up-front impact of the policy by removing the need for lenders to conduct a historic review of debtors' tax positions.

d. Tax penalties and interest should not be elevated to preferential status. This would cause considerable administrative issues and would increase the cost of insolvency procedures. If the Government does not do this, it should agree to deduct the cost of agreeing penalties and interest from the HMRC dividend.

e. Preferential status will create an administrative burden for HMRC by creating additional duties for HMRC in insolvency procedures. HMRC must be sufficiently resourced and skilled to ensure it can fulfil its duties efficiently.

f. The Government must reconsider its impact assessment, and should look at the wider impact of the policy on the taxpayers it is seeking to protect. We are deeply concerned that the losses likely to be incurred by the taxpayer as a result of lower instances of business growth and business rescue will be greater than the expected direct revenue gains.

g. Most importantly, there are means within both the existing insolvency framework and through other government policy proposals which would better protect taxpayers in insolvency procedures than the proposal covered in this consultation (see paragraphs 143-146).

Alternative reform proposals

142. As referred to above, the Government has already proposed a number of potentially positive reforms to the corporate insolvency framework. Although further work is needed, many of these reforms (those based on the 2016 corporate insolvency framework review[38], rather than 2018's corporate governance and insolvency consultation[39]) have the potential to improve the chances of business rescue in the UK. As noted above, business rescue is likely to result in better returns from insolvency procedures for all creditors – including HMRC. The Government – and the taxpayer – would be better served if it were to focus on the introduction of the corporate insolvency reforms rather than continuing with plans to reintroduce Crown Preference.

Alternatives within the existing framework

143. Ultimately, the opportunity to improve returns to HMRC through insolvency procedures is already present in the existing insolvency and restructuring framework. As previously noted, HMRC has a reputation for failing to engage in insolvency procedures and restructurings, as well as for not taking a commercial approach in these situations. This approach undermines the effectiveness of insolvency procedures and restructurings from

[38] 'A Review of the Corporate Insolvency Framework', 25 May 2016
[39] 'Insolvency & Corporate Governance', 20 March 2018

HMRC's perspective. Feedback from our members is that the more engagement creditors put into an insolvency procedure or restructuring, the more they will get out.

144. More effective HMRC engagement in insolvency procedures would entail HMRC exercising its existing voting rights on a more regular basis, and adopting a more commercial approach to supporting restructuring and business rescue efforts: decisions should be based on what will maximise HMRC's returns in a case.

145. As part of R3's survey, we asked our members to compare the impact of the proposed policy to the potential impact of a policy of greater HMRC engagement in insolvencies. 78% of respondents feel that it would be more beneficial for HMRC to engage more in insolvency procedures than it would be to reintroduce Crown Preference, with 59% saying it would be *much* more beneficial. Just 6% feel that reintroducing Crown Preference would be more beneficial than more HMRC engagement.[40]

146. In summary, it is R3's view that the Government would see greater benefits if HMRC were to engage more fully in insolvency procedures, rather than trying to jump the queue in insolvencies by introducing the proposed policy.

[40] R3 Member Survey, 7 March 2019 – 23 April 2019, 305 respondents