



Rt Hon Sajid Javid MP  
Chancellor of the Exchequer  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Friday 7 February 2020

Dear Mr Javid,

**Budget 2020: An opportunity to avoid a potential £1 billion blow to UK business lending and rescue**

I write as President of the insolvency and restructuring trade body R3, to summarise our members' views ahead of your Budget Statement on 11 March. This submission highlights our profession's serious concerns with the potential impact of two policies due to be included in the upcoming Finance Bill: measures to make directors personally liable for a company's tax liabilities where HMRC considers avoidance or evasion has taken place, or where there is evidence of 'phoenixism'; and the Government's plans to grant HMRC 'preferential status' in insolvency procedures from April this year.

The latter policy, in particular, represents a significant challenge to the UK's business community as it risks making it harder for businesses to access working capital finance. As well as having a detrimental impact on business and economic growth, restricted lending will make it harder to rescue businesses, increasing the knock-on effect of the insolvency of one business on other businesses and individuals. Business investment, returns to creditors, and confidence in the UK's corporate framework all stand to be damaged as a result. We have responded with our members' concerns to the consultations on this policy and have met officials, but have been disappointed that our feedback – which is echoed by lenders, business groups, and others – appears not to have been taken fully into consideration.

We urge the Government to take on board the concerns outlined below. While the 'tax abuse and insolvency' measure can be mitigated through accurate legislative drafting and detailed guidance from HMRC, the policy to grant HMRC preferential creditor status should be withdrawn entirely. Its introduction may prove a hammer-blow to business rescue and lending across the UK, at exactly the time when the Government is seeking to 'level-up' the economy.

**HMRC's position as a creditor in insolvency procedures**

In insolvency procedures, creditors are repaid according to a strict, statutory hierarchy. Because an insolvent business is very unlikely to be able to repay all its debts, the lower a creditor is down the hierarchy, the less of their money – if anything – they are likely to see back. Under the Government's plan, some HMRC debts such as PAYE, employee NICs, and VAT, will move 'up' the hierarchy. Other tax debts, such as Corporation tax or employer NICs, will remain an unsecured debt, lower down the hierarchy.

This plan reverses changes made by the Enterprise Act 2002, which removed HMRC's preferential status and established tax debts as an unsecured debt in insolvencies. This Act was designed to encourage investment and entrepreneurialism and has long been considered a success.

### *Impact on pensions, suppliers, customers and lenders*

The creditors most affected by the changes are those leapfrogged by HMRC: ‘floating charge’ creditors (who lend against a changing asset, such as stock) and unsecured creditors (such as the company pension scheme, some employee claims, and the company’s suppliers or customers – including SMEs and consumers). The extra money HMRC gets as part of the proposed reform will be coming from what would otherwise be repaid to these other creditors.

Unlike the pre-2002 approach, tax debts will now qualify for preferential status regardless of when they arose. Previously, only tax debts arising in the 12 months prior to insolvency benefitted from preferential status. The lack of a time ‘cap’ for HMRC’s claim means other creditors could get even less back in insolvencies than they did before the Enterprise Act 2002.

The proposal is ‘retrospective’: while it will apply to insolvencies starting after 6 April 2020, any tax debts from before this date will have preferential status, while any floating charges created before this date will be outranked.

### *The impact on business rescue and funding*

The squeeze on ‘floating charge’ lenders could have a big impact on business rescue and funding. Floating charge lending is a very common form of business finance, particularly for SMEs and sectors like retail. With lenders facing the possibility of not seeing any of their money back if a company becomes insolvent, they will be less willing to lend, particularly to those companies already in financial distress but who may be able to turn themselves around with fresh funding. This is bad news for the UK’s businesses, which need reliable access to finance to operate. The removal of HMRC’s preferential status in the Enterprise Act 2002 contributed to the growth of floating charge lending in the first place.

While noting it is difficult to accurately model the policy’s impact on business lending, **UK Finance estimates that the policy could hit lending by up to £1.5bn.**

### *Impact on UK businesses*

Because the policy may force floating charge lenders to reduce the size of borrowing facilities, some now-overdrawn borrowers will be pushed into the red overnight. Additionally, the proposal’s ‘retrospective’ nature means, in order to check for tax debts which may now outrank their claims, floating charge lenders will have to undertake a detailed historic and ongoing review of the tax positions of the companies to whom they lend. This will further increase the cost of obtaining floating charge financing.

### *Impact on HMRC*

As a preferential creditor, HMRC will have additional responsibilities in insolvency procedures, creating the risk of a bottleneck: HMRC’s lack of engagement can *already* cause delays in insolvency procedures; more tasks for HMRC may mean more delays, exacerbating the impact of the proposal on other creditors. Ultimately, with restrictions on business funding, there will be less business growth and more business failure: as a result, in the long-term, this policy could actually reduce tax revenue.

### *A change of direction needed*

In order to prevent damage to UK business rescue and lending, pension schemes, supply chains, and consumers, the Government should drop its plans. At the very least, the Government must scale back the scope of its proposals. To provide certainty about the size of HMRC’s preferential claims, the

Government should cap the age of tax debts eligible for preferential status; and, to ensure the policy is fair and that its administrative impact is minimised, HMRC's preferential claim should not outrank floating charges created before April 2020. Greater HMRC engagement in insolvency procedures would also be a more effective way of increasing post-insolvency tax returns.

## **Tax Abuse and Insolvency**

The Government's 'tax abuse and insolvency' policy will make directors personally liable for tax debts in situations where they are suspected of abusing the insolvency framework in order to avoid paying taxes. This could apply to directors with a track record of corporate insolvency, or where the director's company is facing, or in, an insolvency procedure.

While R3 understands the issue which the Government is seeking to address, we are concerned that, without strict guidance to accompany the legislation, there is a risk that it may be applied much more widely than originally intended.

The implications of the policy are significant: it breaches the principle of 'limited liability' which lies at the heart of the UK's corporate framework. As such it must be handled with care and used sparingly. It is also worth noting that the Government already has a number of powers to pursue tax debts which are far stronger than those possessed by other types of creditor.

While officials appear to have taken on board some of our feedback on earlier versions of the proposals, we have some remaining concerns.

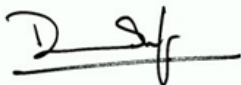
For example, while an individual will have a right to review the decision by HMRC to use the power, the individual will not be able to challenge the existence or amount of any tax liability for which they are being held responsible.

Additionally, the legislation will allow HMRC to make individuals liable for corporate tax debts if (among other criteria) they have links to a number of corporate insolvencies in the recent past. Given the nature of their work, turnaround specialists would satisfy this criterion, but it would be unfair for these individuals to be included within the scope of the legislation. In correspondence with one of our members, your colleague, Rt Hon Jesse Norman MP, indicated that the policy will not be applied to turnaround specialists. While this is encouraging, the wording of the legislation and subsequent guidance will be key to ensuring this commitment can be honoured.

Finally, among the criteria which need to be met before the power can be used are requirements that there is a "serious risk" of insolvency, or a "serious possibility" that a tax liability may not be paid. These terms are somewhat vague and are open to interpretation. R3 urges the Government to take these points into account ahead of the Budget next month.

We would be delighted to meet with you or your officials to discuss these matters in more detail, and we will be in touch with your office to this end. In the meantime, if you or your officials require any further information please do not hesitate to get in contact with R3's Public Affairs Manager, James Jeffreys, on 020 7566 4220 or at [james.jeffreys@r3.org.uk](mailto:james.jeffreys@r3.org.uk).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D Swift', with a horizontal line drawn underneath.

Duncan Swift  
R3 President