HMRC to be reinstated as “preferential creditor”

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Following a recent government consultation, new draft legislation is expected this summer which will render HMRC as a “secondary preferential creditor” in insolvencies that commence on or after 6 April 2020. The government’s objective is to ensure that more tax which is collected on behalf of HMRC (circa £1.9bn) is actually paid to HMRC and used to fund public services, and is not distributed to pay other creditors.

In an effort to stimulate business recovery at the time, the Enterprise Act 2002 changed HMRC’s status as a preferential creditor for certain taxes to that of a non-preferential creditor for all forms of tax. The proposed Finance Bill will reverse this position and reinstate HMRC’s “preferential creditor” status for specific tax debts that a business collects from its employees, contractors and customers (including PAYE deductions, employee national insurance contributions, construction industry scheme payments and VAT) which are due at the commencement of the insolvency. HMRC will move up the hierarchy, being paid ahead of holders of floating charges and non-preferential unsecured creditors, but not ahead of lenders with fixed charges, IP’s fees or preferential creditors (which includes certain employee claims).

The rules remain unchanged for tax debts owed by the business. Penalties and interest on tax debts will not form part of HMRC’s preferential claim since these are not charges paid by employees or customers.

Concerns have been raised that ordinary suppliers and traders to the insolvent business (which may, themselves, be struggling in the current economic climate) will be pushed lower down the recovery chain, which in turn could be detrimental to overall trade and the wider economy. Other concerns are that lenders will become more cautious and/or increase lending costs making it harder for businesses to obtain finance to overcome temporary hardship, and IPs will face the administrative burden of verifying HMRC’s entitlement.

These concerns are not shared by the government and it is expected that the new legislation will follow without further consultation.

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