Reintroduction of Crown Preference from 1 December 2020: The Winners and the Losers

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From tomorrow, under the Finance Act 2020, HMRC will regain its status as a preferential creditor for insolvencies that commence on or after 1 December 2020.

This means that, in an administration or liquidation, HMRC moves up the rankings of who gets paid out first, jumping ahead of floating charge creditors and unsecured creditors.

By way of background, HMRC lost its preferential status back in 2003, following the introduction of the Enterprise Act 2002. The Act abolished the Crown's preferential status and instead provided that a 'prescribed part' of floating charge realisations be made available for distribution to unsecured creditors - of which HMRC was one.

The Finance Act of 2020 will, however, see HMRC move up the creditor hierarchy for the distribution of assets in the event of insolvency.

According to the new legislation, from 1 December, when a business enters insolvency, certain taxes due from an insolvent business, including VAT, PAYE Income Tax, employee National Insurance contributions, student loan deductions and Construction Industry Scheme deductions temporarily held by the business, will go to fund public services rather than being distributed to other creditors.

The rules will remain unchanged for taxes owed by businesses themselves, such as Corporation Tax and employer National Insurance contributions, where HMRC will remain an unsecured creditor.

Who is affected?

With HMRC moving up the rankings, there will be reduced funds available for unsecured creditors, which is likely to result in these creditors being less willing to engage in the insolvency process, including voting on resolutions and providing information for or supporting investigations. The reduction in returns from insolvencies could lead to increased numbers of business failures.

Adding to this, HMRC's preferential status could make the implementation of CVAs more challenging, with unsecured creditors being less likely to support rescue packages such as CVAs, leading to further business failures.

While the measures will impact on all businesses and other organisations who are creditors involved in an insolvency, prioritising the recovery of HMRC's tax debt could mean that secured creditors, such as asset-based lenders, in particular are affected, as they are the main holders of

floating charges, which cover assets such as stock, receivables (unless subject to an invoice finance agreement) and cash in the bank.

They, along with other creditors, could receive a reduced dividend and may change their lending practices as a result of this measure, becoming more cautious in providing funding, increasing funding costs to compensate for the increased risk they carry, and reviewing how their security is structured, potentially seeking more personal guarantees from directors and family members.

HMRC, on the other hand, is set to be the biggest winner, as shown in the following table:

Exchequer impact (£m)

2018 to 2019	2019 to 2020	2020 to 2021	2021 to 2022	2022 to 2023	2023 to 2024
nil	+10	+65	+150	+195	+185

Table 2.1 of Budget 2018 for the combined measures 'Withheld Taxes: protecting your taxes in insolvency and tackling abuse'.

Andy Pear, Partner, BM Advisory, comments: "With significant levels of government debt to be repaid, as we emerge from the COVID pandemic, the timing of the introduction of this new legislation is questionable. While HMRC is adamant that it remains supportive of the UK's rescue culture, businesses are battling against a tide of challenges, and the new creditor status could cause significant harm to business rescue efforts at a critical time for the economy.

"The irony in this is that, while the legislative changes aim to help government balance the books following a torrid year, more businesses are anticipated to become insolvent in the coming months as we emerge from the COVID crisis, meaning less businesses paying taxes to support the economy."