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# OUR GUIDE TO HMRC PREFERENTIAL STATUS

Many younger members of the insolvency profession do not remember when HM Revenue & Customs ("HMRC") held preferential status in the pecking order of insolvency distributions.

Prior to the implementation of the Enterprise Act 2002, on 15 September 2003, HMRC was a preferential creditor for, principally:

- 6 months of outstanding VAT; and
- 12 months of outstanding income tax and NICs.

**What is a preferential creditor?**

The Insolvency Act 1986 defines preferential debts that can be claimed in both corporate and individual insolvencies, giving debts that would otherwise be unsecured priority over other unsecured creditors and priority over creditors with floating charge security; such as banks.

Preferential creditors are, therefore, generally paid first in an insolvency after the costs and expenses have been settled.

**The Autumn budget 2018**

One of the minor provisions of the Government's budget was that it intends to introduce legislation in the Finance Bill 2019-20 to make HMRC a secondary preferential creditor for taxes paid by employees and customers.

Becoming a secondary preferential creditor would move HMRC back above creditors who hold floating charges and the general body of unsecured creditors. Primary preferential debts would remain contributions to occupational pension schemes and certain claims of employees.

There is no indication that there would be a time limit on the period over which the secondary preferential debts have built up.

**The consultation**

HMRC have issued a consultation paper on the proposed measures that closes on 27 May 2019.

**The benefits to Government**

Somewhat surprisingly, the financial impact of re-introducing preferential status for HMRC is only anticipated to bring in £150-195 million per annum in the tax years 2021 to 2024. This is modest given the anticipated repercussions this could have on access to credit for businesses.

**The implications for businesses**

Funders with floating charge security have lent money in the knowledge that, since 2003, they would sit behind employees' wages, holiday pay and pensions contributions in the order of priority to be paid from an insolvency. Whilst approximately 20% of what they could receive would be passed down to the general body of unsecured creditors (through the Prescribed Part) the majority of realisations, after costs, would be available to repay them. With the proposed changes, it is highly likely that lenders will become more cautious in respect of how much they will lend and will want to know that a business is paying its taxes as and when they fall due.

Likewise, credit between business has been offered on the basis that HMRC would rank at the same level and would receive the same proportion of its debt as the trade suppliers and general creditors of a failed business. As it is looking likely that unsecured creditors will, in future, receive less by way of a dividend than they have done since 2003, it would be understandable if credit becomes harder to obtain. This is often the life blood of a new business that does not have significant working capital on day one, or a business that is experiencing a period of growth.

If you would like specific guidance for you or your company, talk to Sadlers today.