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Rt Hon Sajid Javid MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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3 September 2019

Dear Chancellor,

Preferential status for tax debts in corporate insolvencies – Brexit implications

We are writing to express some further concerns regarding the Government's proposal, published by your predecessor in the Draft Finance Bill 2019-20, to elevate some tax debts to preferential status in insolvencies, and to urge the Government to reconsider its position. Our observations are additional to those already expressed in a joint stakeholders' letter to you dated 3 September 2019, to which we were co-signatories. We are on record as opposing the proposal for a variety of reasons to which no answer has been given[1] but these further observations are specifically directed to the incompatibility of the proposal with other Government policy and, in particular, its Brexit preparations.

In summary, the proposal is to shift the burden of certain bad tax debts from HMRC into the wider economy by according them secondary preferential status ie ranking behind employee claims, alongside depositor claims against failed financial institutions and ahead of floating charges and the general body of creditors. The amount of lost tax revenue is a tiny proportion of total Government revenue but its potential effect on distributions to creditors in any given insolvency could be very substantial.

Depositor protection

One of the more egregious aspects of the proposal is that it would rank the relevant tax debts alongside those claims of retail depositors which are outside the limits of the Financial Services Compensation Scheme. The existing priority of those retail depositors was introduced as part of the suite of measures in the wake of the financial crisis to promote financial stability and, more particularly in this particular instance, to improve confidence in the retail banking sector. As such, it is surprising that the Government's new policy is to erode those protections.

We wish to draw your attention to two points:

[1] See our response to the original HMRC consultation at:
http://www.citysolicitors.org.uk/attachments/article/119/CLLS%20%20response%20to%20HMRC%20consultation%20-%20April%202019.pdf

1. In the case of a failed financial institution with eligible depositors, the Government will face the predictable criticism that debt due to HMRC is being paid out of depositors' savings.

2. Secondary preferential status for depositors is an EU standard. The proposed measure derogating from that standard will enable EU Member States to make adverse comparisons between the treatment of depositors with UK banks and that accorded to depositors with their own banks. This is incomprehensible in the context of preparations for Brexit and the general policy imperative of UK financial institutions competing for business in a post-Brexit economic environment.

Operation Kingfisher

The proposal makes the Government's policy and its Brexit preparations incoherent:

1. It is Government policy to promote the UK as a business-friendly jurisdiction and, as part of that initiative, to improve the UK's standing in World Bank rankings of insolvency laws. The ranking of UK insolvency laws has slipped in recent years and is ripe for reforms which BEIS is currently advancing. The abolition of preferential status for Crown debt was part of earlier reforms introduced by the Enterprise Act 2002 which reflected an international trend. It seems perverse, in the context of Brexit, to reverse that reform, thereby undermining the policy of improving World Bank rankings and inviting negative comparisons with other jurisdictions competing for foreign investment.

2. The purpose of the proposal to reintroduce priority ranking for certain tax debts is to cast the burden of those debts on those ranking alongside or below those debts. We have already commented above on the position of retail depositors; we refer here to the position of floating charge holders and the general body of creditors. The policy has been presented as transferring the burden of loss from the taxpayer on to banks (as the usual holders of floating charges). We understand that this has a populist appeal but suggest that it is misleading in two respects:

(a) as has happened with previous incursions on floating charge security, banks are likely to respond by increasing their reliance on asset-based lending to the disadvantage of all other creditors (including employees and the Government in its capacity as guarantor and subrogated creditor in respect of those claims); and

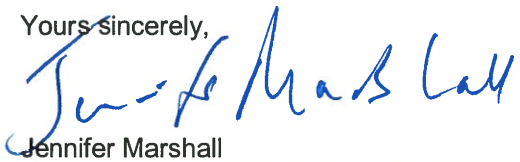
(b) even though floating charges rank above the general body of creditors, the dividend prospects of the general body of unsecured creditors (as well as potential returns to secured lenders) will still be damaged by taking any of HMRC's claims out of that category and according them priority.

For those reasons, we suggest that these proposals should not simply be seen as transferring value from the banks to the taxpayer (although we refer to the joint stakeholder letter as to why the proposals will be damaging to floating charge lending). The real impact will be felt by the general body of unsecured creditors – not least because of their entitlement to distribution of the "prescribed part" ahead of floating charges (another Enterprise Act reform). The present maximum for the prescribed part is £600,000 but it is Government policy to increase that maximum to something in the region of £800,000. Such a policy is simply incompatible with the proposal to accord HMRC secondary preferential status. On the one hand the Government, as part of its mission to stimulate entrepreneurial activity in a post-Brexit environment, is seeking to increase the returns for the general body of unsecured creditors, whilst HMRC is seeking a new priority which may, in many cases, eliminate the prescribed part altogether.

3. It has been widely reported in the press that, as part of its Brexit planning, the Government is preparing a new package called "Operation Kingfisher" to provide a contingency fund for the express purpose of supporting businesses experiencing temporary solvency issues. We welcome the recognition that economic turbulence following Brexit may threaten otherwise viable businesses which will need support if they are to survive (and not bring down yet further businesses because of the potential domino effect of insolvencies). It is inexplicable that the Government should be recognising the need for such measures and creating such a fund whilst simultaneously proposing to elevate the collection of certain tax debts over the claims of other creditors, thereby exacerbating the very problems which the fund will have to address.

For all those reasons, we urge you to reconsider the Brexit implications of the policy to prioritise HMRC's claims.

Yours sincerely,



Jennifer Marshall
Chair, for and on behalf of, City of London Law Society Insolvency Committee

Appendix

Members of the CLLS Insolvency Sub-Committee

Jennifer Marshall (Allen & Overy LLP) (Chair)

Catherine Balmond (Freshfields Bruckhaus Deringer LLP) (Vice Chair)

Hamish Anderson (Norton Rose Fulbright LLP)

Joe Bannister (Hogan Lovells International LLP)

Giles Boothman (Ashurst LLP)

Adrian Cohen (Clifford Chance LLP)

David Ereira OBE (Paul Hastings LLP)

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Ben Larkin (Jones Day LLP)

Dominic McCahill (Skadden Arps Slate Meagher & Flom (UK) LLP)

Ross Miller (Simmons & Simmons LLP)

Byron Nurse (Dentons UKMEA LLP)

Kevin Pullen (Herbert Smith Freehills LLP)

James Roome (Akin Gump Strauss Hauer & Feld LLP)

Peter Wiltshire (CMS Cameron McKenna Nabarro Olswang LLP)

Jo Windsor (Linklaters LLP)