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The return of Crown Preference

From 1 December 2020 HMRC will become a secondary preferential creditor in insolvencies (corporate and personal). The provisions can be found within the Finance Act 2020 at page 79, Part 4, Miscellaneous and Final, Insolvency, HMRC debts: priority on insolvency. "Schedule 6 'The Categories of Preferential Debts' of the Insolvency Act 1986, has been amended. From 1 December 2020 certain HMRC debts will fall within the categories of preferential debts, however, these debts will rank at the bottom of the ladder of these types of debts. All other preferential debts listed in schedule 6 (importantly arrears of wages and holiday pay) must be paid in full before HMRC are to receive a distribution under its secondary preferential status.

The new HMRC debts that are captured are **VAT** or a **relevant deduction**, which is as follows : "(a) the debtor is required, by virtue of an enactment, to make the deduction from a payment made to another person and to pay an amount to the Commissioners on account of the deduction, (b) the payment to the Commissioners is credited against any liabilities of the other person, and (c) the deduction is of a kind specified in regulations under section 99(3) of the Finance Act 2020." For example, PAYE and employee National Insurance Contributions (NICs). Other tax debts, such as Corporation Tax or employer NICs, will remain as unsecured non preferential debts.

The Insolvency Act 1986 (HMRC Debts: Priority on Insolvency) Regulations 2020 clarifies a 'relevant deduction'

The deductions are:(a) deductions under section 61 (deductions on account of tax from contract payments) of the Finance Act 2004(5), **Amounts withheld under the construction industry scheme** (b) deductions under paragraph 6(1)(b) (deduction of earnings-related contributions) of Schedule 4 to the Social Security (Contributions) Regulations 2001(6), **Employee national insurance contributions** (c) deductions under regulation 21 (deduction and repayment of tax by reference to employee's code) of the Income Tax (Pay As You Earn) Regulations 2003(7), and **Amounts withheld under Pay As You Earn** (d) deductions under regulation 50 (deductions of repayments) of the Education (Student Loans) (Repayment) Regulations 2009(8). **Student loan repayments via payroll deduction**. Self-assessment income tax liabilities and related NIC charges in personal insolvencies such as IVAs and Bankruptcies will remain unsecured debts.

Commentary on Crown Preference

The effect of the return of Crown Preference is likely to be that in many corporate insolvencies, substantially reduced funds will flow to floating charge creditors (banks and others), and therefore also to unsecured creditors than before the change. This may lead to a reduction in credit availability and banks evaluating loans more carefully when lending to companies. The insolvency profession argued against this change for those reasons.

Office news

Giles Frampton retired as a Partner on 30 September 2020. He remains as a Consultant. We wish him a happy retirement. Jonathan Trembath who joined us as a Manager in May 2019 became a Partner from 1 October 2020.

Revival of suspension of wrongful trading provisions of sections 214 and 246ZB of the Insolvency Act 1986 and company meeting rules relaxation extended

When considering liability for wrongful trading, directors may not be held responsible for any worsening of the financial position of the company between 26 November 2020 and 30 April 2021. The latter date is subject to change if the suspension of wrongful trading liability is no longer required to prevent companies which would be viable but for the impact of the pandemic from entering insolvency proceedings unnecessarily.

In addition, the period during which temporary relaxations to the manner in which company AGMs and other meetings must be held, as provided for by the Corporate Insolvency and Governance Act 2020 (the CIG Act), has been extended to 30 March 2021.

Insolvency Service Statistics Case numbers (E&W)

	2020		
	Q1	Q2	Q3
Corporate			
Compulsory Liquidations	707	205	292
Creditors' Voluntary Liquidations	2,668	2,302	1,920
Administrations	400	389	396
Company Voluntary Arrangements	69	47	63
Receiverships	1	1	1
Personal			
Bankruptcies	4,314	2,505	2,759
Debt Relief Orders	6,862	4,792	4,465
IVAs	16,361	25,566	12,559

Commentary on statistics

The reduction in company insolvencies in the latest quarter compared with last year was likely to be in part driven by the range of Government support put in place to financially support companies in response to the coronavirus (COVID 19) pandemic. The Government also announced in late April that it would temporarily prohibit the use of statutory demands and certain winding-up petitions from 27 April to 30 June 2020. This was further extended to 30 September under the Corporate Insolvency and Governance Act and in August 2020 was further extended to 31 December 2020.

Compulsory liquidations require a winding-up order obtained from the court by a creditor, shareholder, or director. Since the UK lockdown was applied on the evening of 23 March 2020 to slow the spread of the coronavirus, the HM Courts & Tribunals Service has reduced the operational running of the courts and tribunals, therefore reducing the numbers of compulsory liquidations. Over half of compulsory liquidation (51%) with a court order date in Q3 2020 had a petition date two quarters previously in Q1 2020. Internal analysis of management information shows that petition activity has decreased substantially, with the recent increase in the number of compulsory liquidations in Q3 driven primarily by HM Courts & Tribunals Service resuming processing petitions presented prior to the UK lockdown.

The fall in DROs and Bankruptcies in Q2 and Q3 corresponds with a reduction in applications for these services which coincided with the announcement of enhanced government financial support for individuals and businesses since the emergence of the Covid-19 pandemic. The odd Q2 IVA figure arises as a result of a lag in IVA registration by a volume IVA provider.

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