BUDGET SURPRISES

Time to dust off your old manuals?

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MANY of the initial reports of the budget streaming into your inbox will have cheered small businesses, focused as they were on income tax, digital commerce tax and business rates cuts. However in the world of insolvency and therefore in the wider credit arena, two areas of the budget sent shockwaves through the finance and insolvency professions and will have a radical effect on credit, business start-ups and rescue as well as the very concept of limited liability.

First, the big announcement, in respect of which there was no prior warning or consultation (even, it seems within HMRC or BEIS) the resurrection of crown preference in insolvency. The view is that VAT, Employers' NIC, PAYE and CIS are all taxes collected on behalf of the Crown and therefore should not form part of the available funds for unsecured creditors in an insolvency. For example, Company A supplies Company B with widgets for £1,000 plus VAT. Company B pays Company A £1,200 – £1,000 is for the widgets and £200 is for Company B's VAT payment which Company A should pay over to HMRC. So far so logical. However, in a real-life situation cash fluctuates and all the VAT, to take one example, is not sitting in a deposit account for HMRC but is used in the business of Company A. So long as Company A pays that VAT over to HMRC on the due date no problem, but if Company A is insolvent and the £200 is no longer there, the administrator or liquidator of Company A will realise its assets and, where appropriate, bring claims against directors to replenish the company pot for creditors. At present, aside limited preferential creditors such as employees, the company pot after payment of secured creditors is paid to the unsecured creditors – including HMRC – 'pari passu'.

In administration the Enterprise Act 2002 which abolished Crown preference also made provision for a 'prescribed part' carved out of floating charge realisations (as floating charge holders were getting a Crown windfall in the Crown no longer being preferential) of up to £600,000 for unsecured creditor then including the Crown. From 2020 it seems the prescribed part will change or go. In insolvent estates HMRC will rarely have trust money in the form of carefully preserved tax to recover so will eat into unsecured creditor returns generally.

At the time of the Enterprise Act arguments were made that the abolition of Crown preference was good for business and for UK plc. They were right. The old order meant that HMRC were far too quick to liquidate and make a grab for their cash when in fact business rescue was feasible. This is a shortsighted move even if done in the name of the good of the taxpayer. What UK plc needs is a good flow of lending, a good rescue culture, and an efficient pursuit of those who trade at the expense of their creditors and fail. Instead lending and trade credit will tighten and the Crown might well find that its take goes down not up. All this at a time when businesses face the Brexit challenge. While the changes announced do not usurp the position of secured lenders with fixed charges, many of the challenger lenders who have proved so vital in SME lending do not have fixed charges and might look harder at their lending criteria.

BARRIER TO BUSINESS

As if this wasn't bad enough the other HMRC proposals, which were (briefly) consulted upon-and apparently universally condemned-in their 'Tax Abuse in Insolvency' paper, have also been adopted in the budget. These proposals allow HMRC – as Judge Jury and Executioner – to determine when a company is guilty of tax evasion or avoidance, or phoenixism, and look directly to directors for recovery. Again, this must tighten lending. The Treasury has previously been keen to resist any erosion of limited liability as a barrier to business, but it seems that this is all forgotten in a short-term land grab by HMRC.

Many now successful businesses have arisen from early failure. Would entrepreneurs try again so readily if their family home is on the line? Would a lender support them trying again or provide a distressed business with finance under the post 2020 regime? Less likely. Fewer and fewer businesses are built on fixed asset bases in the SME market. Floating charge and unsecured lending has enabled such business to thrive.

Time to tighten your credit policies?

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