

Plan companies should not seek to wipe HMRC debt entirely

Recent cases have started to show what is needed to persuade a court to cram down HMRC and sanction a restructuring plan, say **Jennifer Jones** and **Rachael Markham**

We know that it is possible to cram down HMRC using restructuring plans, but not without good reason. In a battleground that ultimately turns on individual circumstances, there are some general lessons we can learn from recent cases that might assist in persuading a court to exercise its discretion to cram down.

Pre-plan preparation

Some of the recent criticisms levied against plans by HMRC stem from a lack of engagement by plan companies. Where HMRC is a key stakeholder, ensuring that it is engaged from the outset (even if not onsite) will put a plan company in a better position to persuade the court to cram the plan down on HMRC if it will not support it.

Factors that have weighed against cramming down HMRC include the age and size of accrued tax debts as well as the historic relationship between HMRC and the restructuring plan company. Where the plan company has a poor relationship with HMRC – for example where it has a history of failed time-to-pay arrangements (TTP) – the plan company should not expect the court to force HMRC's hand to enter a TTP or wipe out Crown debt entirely.

If the company is part of a wider group, the tax position of the entire group will also be relevant – including the size and age of the group debt.

Engaging with HMRC and agreeing a new TTP alongside the plan, or at least getting an agreement in principle, will reduce the risk of challenge. However, if a TTP has not been agreed before sanction, this is not necessarily fatal. It is nevertheless important that the plan company is fair and transparent with HMRC from the outset, including ensuring that potential antecedent transactions have been disclosed and that HMRC's position is not purposefully disadvantaged.

In *Prezzo* [2023] EWHC 1679 (Ch) the company provided HMRC with extensive financial information to answer and address HMRC's concerns and to assist with its evaluation of the plan. It also offered an

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additional payment to HMRC between the convening and sanction hearing. Notwithstanding HMRC's continued objections, the court did cram down the plan on HMRC.

Terms of the plan

HMRC does not have priority status under a plan. It is an unsecured creditor in respect of all accrued tax debt. However, recent cases have seemingly elevated HMRC's position above that of other unsecured creditors, with judges noting HMRC's 'special status' given that it is an involuntary creditor. That does not mean that plan companies must pay HMRC's preferential debts in full as a matter of principle but there is, it seems, a scale. And, of course, HMRC is likely to be preferential in the relevant alternative.

At one end of the scale, the plan could offer HMRC what it would receive in the relevant alternative. This would meet the 'no worse off test', but if the outcome under a plan compared to the relevant alternative is marginal this is (as HMRC have done) likely to be challenged. At the other end, the plan could offer to pay HMRC in full, but this may not be financially possible.

Reaching a point somewhere between the two ends of the scale seems fair because it recognises on the one hand that HMRC is an involuntary creditor and is therefore different to other unsecured creditors, but on the other that it does not have priority status (save that

companies need to consider whether HMRC should be treated as a critical creditor – see further below).

How do you reach the mid-point such that HMRC will either agree to the plan or the court will sanction cram down?

Paying more

The obvious starting point is to consider whether the plan company can pay or provision for the preferential element of HMRC's claim in full. It is arguably only the preferential part of HMRC's debt that has to be treated differently because it is that debt that has priority status in the relevant alternative.

Although HMRC should not expect to be paid in full, doing so is more likely to gain HMRC's support or secure cram down of the unsecured part of HMRC's debt.

Paying HMRC more than other unsecured creditors (unless they can properly be classed as critical) and/or paying more than HMRC would get in the relevant alternative is likely to assist in securing cram down. This would recognise HMRC's elevated status above other unsecured creditors as has been highlighted in some of the recent cases.

The approach taken in *Prezzo* was to offer HMRC a payment equivalent to what it would receive in the relevant alternative plus an additional £2 million. The additional payment essentially reflected the costs savings before it became uneconomical to proceed with the plan. Looking at the costs saving between a plan and the relevant alternative and offering that to HMRC to ensure it is 'better off' is likely to be persuasive.

Paying the debt over a longer period

Typically, a TTP will be structured over a maximum period of 12 months in the current climate, but there appears to be no obvious reason why a plan cannot structure repayment over a longer period if the company is unable to pay in full immediately. That HMRC must wait for payment does not automatically mean it is being treated unfairly, particularly if other key stakeholders (lenders, bond holders, etc.) are prepared to defer or extend repayment terms. If HMRC is also paid interest, then why would the court not exercise its power to

cram down, provided HMRC is otherwise 'no worse off'? This seems to strike a fair balance between HMRC's role as tax collector and the plan company's need to address its financial position. That said, if a company can repay HMRC's preferential debt quicker than it would receive payment in the relevant alternative as part of a plan, that may also be a persuasive factor for cram down.

Fair distribution of the surplus

One of the biggest considerations needs to be how the restructuring surplus (the value created by the plan) will be distributed among creditors and, as part of that, is HMRC receiving a fair share? There is not a one-size-fits-all approach but a plan company should consider the following:

- Who is contributing to the restructuring surplus?
- Are new monies being injected into the plan company?
- Has HMRC contributed to the restructuring surplus because the company has not paid accruing tax debt while the plan is being proposed?

Those contributing to the surplus should receive a benefit from the surplus, but how much should this be? HMRC is an involuntary creditor so has no choice but to continue its relationship with the plan company. HMRC's position can and often does worsen between the convening and sanction hearing and (other than taking enforcement action), it can do nothing to prevent that.

Ensuring that HMRC's position as involuntary creditor is acknowledged by increasing the upside for HMRC in comparison to those creditors who have added no value to the plan or, better still, by restructuring and repaying accruing tax debt as part of the plan, is more likely to convince HMRC to support it.

However, if no provision is made for accruing tax debt, this decision needs to be approached carefully bearing in mind directors' duties. If HMRC's debt accrues while the plan is in progress, directors should consider whether their decision not to pay HMRC while paying other creditors is justified.

The approach is akin to the approach directors should take when making decisions about who to pay when a company is distressed: Are they acting in the interests of all creditors by paying X instead of Y? Although the judge in *Prezzo* did not say that the company had traded at the expense of HMRC and accepted the directors' explanation as to why some creditors and not HMRC were paid – (compromising creditors who provided goods and services to its restaurants would jeopardise the survival of the business) we think that this is an area where plan companies should still tread carefully. Ensuring that the company does not



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deliberately worsen HMRC's position without proper justification should be high up the agenda. In some cases, it might be appropriate to treat HMRC as a critical creditor and pay it in full. Although HMRC does not have to be treated as a critical creditor in all cases, some plan companies have been criticised for not considering who the critical creditors are.

It also seems that the higher the percentage return to HMRC, the better. For instance, the court refused to cram down one plan which offered a 'tiny' return, but sanctioned *Prezzo* where HMRC received an overall return of above 30%. However, it is dangerous to read too much into this; there is no *de minimis* and each plan will be different.

Balancing other factors such as the size, age and circumstances of HMRC's debt against how the restructuring surplus is distributed will also be relevant. The larger the debt and the bigger the economic stake HMRC has in the business, the more weight the court will give

to its views as an 'in-the-money' creditor. If HMRC is treated fairly, and arguably better than other unsecured creditors, the more chance a plan company stands to persuade the court to cram down HMRC debt.

What should a plan not do?

It is clear from recent cases that plan companies should not propose a plan that seeks to eradicate HMRC debt entirely, particularly where other creditors stand to gain. A plan is also likely to be resisted by HMRC if it seeks to tie its hands, whether by forcing it (through the plan) to accept a TTP or preventing it from taking enforcement action post-sanction if the company fails to meet its tax obligations. It should be remembered that HMRC is an involuntary creditor and has a duty to collect tax. Imposing a moratorium on HMRC is unlikely to secure its support or gain approval from the court.

Future plans

For SME companies, the easiest way to 'cram down' HMRC may still be via a pre-pack administration. HMRC cannot have a say in that process and will be paid according to the priorities. Unless HMRC is prepared to 'give and take' under a plan, then it will likely force more companies down the administration route. This is not ideal for rescue, but also not ideal for HMRC who will likely receive much less from an administration.



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