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INSOLVENCY INTELLIGENCE

INCORPORATING INSOLVENCY LAWYER

Insolvency Intelligence is a refereed journal

VOLUME **28** NUMBER **3 2015**

3

The Finance Act 2014: the Implications for Companies and Individuals

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LT Accelerated payment notices; Corporate insolvency; HMRC; Tax administration; Voluntary arrangements; Voting rights; Wrongful trading

Introduction

The Finance Act 2014 (FA 2014) received Royal Assent on July 17, 2014. It is a significant piece of legislation forming part of the Government's wider strategy to clamp down on tax avoidance schemes.

By compelling payment of disputed tax where an enquiry or appeal is still underway, through the use of an accelerated payment notice (APN), the FA 2014 aims at removing the cashflow advantage to taxpayers that previously existed in direct tax cases and incentivising them to progress their disputes.

This article considers two issues that may arise out of the FA 2014 in the context of corporate and personal insolvency. The first (in the context of corporate insolvency) is whether officers of a company served with an APN (which it is not in a position to pay) can lawfully continue to trade the company without falling foul of the misconduct provisions of the Insolvency Act 1986 (IA 1986). The second (in the context of personal insolvency) is how the APN is likely to affect a debtor who wishes to enter into an individual voluntary arrangement.

Table of Contents

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Main provisions of the FA 2014

There are two central features of the legislation. The first is the follower notice. This will be used by HMRC in cases where it has already obtained a judicial ruling in its favour in relation to a tax scheme, which it can apply in another taxpayer's case where the same scheme has been used. If a follower notice is issued, the taxpayer must either amend his return (if the return is still under enquiry) or where there is an appeal, enter into an agreement with HMRC to settle the dispute and pay the denied tax advantage.[1] If the taxpayer fails to take these steps, he may face a penalty, which could be 50 per cent of the value of the denied advantage.[2]

The second is the APN, which will usually accompany a follower notice (if the disputed tax has not already been paid). This requires the taxpayer to pay the amount specified in the notice.[3] There is no right of appeal against an APN. However, a taxpayer has 90 days to object to the notice but only on the grounds that the conditions for the notice were not fulfilled, for example, that the amount of the accelerated payment claimed is incorrect.[4]

If not paid, the APN will be enforced deploying all usual enforcement methods, which will inevitably include insolvency proceedings.

Corporate insolvency

Where a company receives, or is about to receive an APN it will be necessary to consider whether the company is thereby rendered insolvent.

Any officers of a company that have received, or are likely to receive, an APN will also need to carefully consider whether they can continue to lawfully trade the company without falling foul of the misconduct provisions contained within the IA 1986 (see ss.212–214). These well-known provisions variously guard against misfeasance by officers of a company, fraudulent and wrongful trading.

The dilemma

Any officers of a company served with an APN are therefore faced with a dilemma accurately summarised by Park J in *Re Continental Assurance Co of London Plc (in liquidation)*[5]:

> "An overall point which needs to be kept in mind throughout is that, whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma.
>
> On the one hand, if they decide to trade on but things do not work out and the company, later rather than sooner, goes into liquidation, they may find themselves in the situation of the respondents in this case — being sued for wrongful trading. On the other hand, if the directors decide to close down immediately and cause the company to go into early liquidation, although they are not at risk of being sued for wrongful trading, they are at risk of being criticised on other grounds. … Ceasing to trade and liquidating too soon can be stigmatised as the cowards' way out."

The nature of liability under an APN

Before considering the position in the corporate insolvency context, it is necessary to determine the nature of the liability that arises under an APN.

Section 219 of the FA 2014 does not expressly say that the amount required to be paid is a debt of the person who has to pay it. Although the liability is provisional in nature the effect of s.219 must be to create a liability to pay. Therefore, where an APN has been issued a debt is likely to have been created.

In circumstances where an APN has not been issued by HMRC, but the company is advised by its accountants that it is likely that an APN will be issued at some point in the future, the question is whether the liability arising under an APN is a contingent or a prospective liability.

It is suggested that the recipient of an APN does not strictly have any contingent liability for the sum sought. A contingent liability is more usually understood to be a liability to a person to whom, under an existing obligation, the company may or will become liable to a current liability on the happening of some future event or at some future date (*Re William Hockley Ltd*[6]).

However, the fact that a company is likely to receive an APN at some future date would probably be held to mean that the company has a prospective liability to pay.

The test for insolvency

Insolvency is an inability to pay one's debts. Subsections (1) and (2) of s.123 of the IA 1986 provide as follows:

> "(1) A company is deemed unable to pay its debts—
>
> …
>
> (e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.
>
> (2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities".

Subsection (1)(e) is often called the "cash-flow" test, while subs.(2) is often called the "balance-sheet" test.

Balance-sheet or Cash-flow test?

It is unlikely that the balance-sheet test would apply to a company that is likely to be subject to an APN. If HMRC served an APN, it would not necessarily follow that the value of the company's assets would be less than the amount of its liabilities. This is because payment under the notice would immediately create an asset of equivalent amount, namely the amount which HMRC would in due course be required to repay if the tax avoidance scheme was upheld.

It is therefore suggested that the correct test to apply in determining whether the company is insolvent is the cash-flow test under s.123(1)(e) of the IA 1986.

Prospective liabilities: The Eurosail case

Sections 123(1)(e) and (2) are subject to detailed analysis by the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc*[7] ("*Eurosail*"). In that case, a borrower, a SPV for a complex transaction, contracted to repay capital sums on dates ranging from a date in 2027 to dates in 2045. Although the borrower could pay its current creditors, events caused by the 2008 credit crunch meant that there was now uncertainty as to whether it would have enough money to make the capital repayments when the time came to do so.

The question for the courts was whether the borrower had become insolvent within the meaning of s.123 of the IA 1986.

Lord Walker[8] noted with approval what Nicholls LJ had said in *Byblos Bank SAL v Khudhairy*[9]:

> "It is … trite to observe that the fact that a company can meet all its presently payable debts is not necessarily the end of the matter, because [the statute] requires account to be taken of contingent and prospective liabilities. Take the simple, if extreme, case of a company whose liabilities consist of an obligation to repay a loan of £100,000 one year hence, and whose only assets are worth £10,000. It is obvious that, taking into account its future liabilities, such a company does not have the present capacity to pay its debts and as such it 'is' unable to pay its debts."

Lord Walker commented that[10]:

> "…the 'cash-flow' test [see s.123(1)(e)] is concerned, not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business. … [O]nce the court has to move beyond the reasonably near future (the length of which depends, again, on all the circumstances) any attempt to apply a cash-flow test will become completely speculative, and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) [see s.123(2)] becomes the only sensible test".

On the facts of the *Eurosail* case, the court concluded that the borrower was not insolvent on either basis. Whether it would be able to pay the capital when it finally fell due in many years' time was a matter of speculation.

Much therefore depends on the available evidence on the specific circumstances of each case. The court, having looked at the company's assets and made proper allowance for its prospective and contingent liabilities, must ask itself whether the company could not reasonably be expected to be able to meet those liabilities.

The best that can be said is that a company is likely to be considered to be insolvent where it receives, or will receive an APN at some point in the reasonably near future, and is unlikely to be in a position to satisfy the demand for payment.

Practical considerations

Dealing with the consequences of APNs is likely to be a growth area for insolvency practitioners. Where an APN is issued or about to be issued it is suggested that accountancy advice is immediately sought on the ability of the company to meet its debts as they fall due.

Prior to entering the insolvency process it is worth considering whether the APN can be challenged. The APN may not comply with the relevant provisions of the FA 2014. A reconsideration might be requested under the FA 2014 or the APN otherwise challenged by judicial review proceedings.

In circumstances where the company is unable to satisfy the demand for payment under an APN, it will be necessary to consider whether the company ought to be wound up on a voluntary basis. Advice should, of course, be sought from licensed insolvency practitioners.

In some cases it may be possible to gradually wind down the company's business on an orderly basis (i.e. by ceasing to accept new work, satisfying existing contracts, collecting debts and paying off outstanding creditors). The company's business goodwill and assets might then be sold to a new formed company (NewCo). In these circumstances it will be necessary to ensure that any transfers of the company's business to the NewCo are made for value and do not prejudice existing creditors of the company.

If the NewCo has a similar name to the company it may be necessary to make an application to the Companies Court under s.216 of the IA 1986 for permission to use the prohibited name.

Individual Voluntary Arrangements (IVAs)

If an individual is issued with an APN, he or she may well be unable to pay it and may have to consider entering an insolvency process. One option is an IVA. HMRC is likely, in most cases, to be in a position to successfully vote against the proposals and prevent the IVA being implemented, even where the claim is disputed by the taxpayer. The reason for this partly turns on the characterisation of the debt that is created by an APN. Its proper characterisation under the Insolvency Rules 1986 (the Rules) may give HMRC significant voting rights or virtually no voting rights at all.

Relevant provisions of the Rules

The relevant provisions in relation to the voting rights of creditors are the following:

- a creditor may vote in respect of a debt for an unliquidated amount or whose value is not ascertained but the debt will be valued at £1, unless the chairman agrees to put a higher value on it[11];
- if the chairman is in doubt whether a claim should be admitted or rejected he must mark it as objected to and admit it subject to the vote subsequently being declared invalid[12];
- a resolution or proposal will be passed if a majority of three-quarters or more (in value) of those present and voting in person or by proxy have voted in favour of it[13]; and
- the relevant date for calculating a creditor's entitlement to vote in the case of a debtor who is not an undischarged bankrupt, is the date of the interim order (if one is in force) or the date of the meeting (if an order is not in force); and if the individual is an undischarged bankrupt, the relevant date is the date of the bankruptcy order.[14]

The Rules therefore place a premium on a creditor characterising its debt as being liquidated or ascertained in amount. The question to be considered here is how an APN is likely to be characterised by a chairman for the purposes of ascertaining HMRC's voting rights at a meeting of creditors.

The case law

There are two cases within the context of company voluntary arrangements which throw light on how HMRC's claims are to be characterised for voting purposes.[15]

Re Portsmouth City Football Club Ltd (In Administration)[16]

HMRC had a claim against Portsmouth City Football Club (Portsmouth) for unpaid PAYE and NIC, which it claimed was due as a result of the use of the Employee Benefit Trusts (EBTs) and payments supposedly for footballer's image rights.[17] HMRC's case was that these arrangements were a sham.

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At the date the club entered administration (the relevant date for characterising and quantifying the debt), HMRC had been investigating Portsmouth and only had an underlying claim. At the date of the meeting, it had issued a revised claim and assessments for £37m. At the meeting, only £24m of the claim was allowed by the chairman, which included only £1 for the "sham" image rights—a claim which the chairman considered was unliquidated or unascertained. HMRC voted against proposals which favoured a special class of unsecured creditors (football creditors) but the proposals were carried. If the claim had been allowed in full, it would have been enough to defeat the proposal. HMRC challenged the decision in the courts.

One of the issues for the court was the correct characterisation of HMRC's debt. HMRC argued that although at the time Portsmouth entered administration, the value of the debt was "unknown" in the sense that no one had worked it out, this was a matter of mere mechanics.

The court considered meaning of an unliquidated and unascertained debt by reference to case of *Re Dummelow Ex p. Ruffle*[18] in which Sir G Mellish L.J. described it in the following way:

> "The question really is, what is meant by 'an unliquidated debt' … The fair construction of the clause seems to me this: … a 'debt, the value of which cannot be ascertained' means a debt the amount of which cannot be estimated until the happening of some future event; and 'an unliquidated debt' includes not only all cases of damages to be ascertained by a jury, but beyond that, extends to any debt where the creditor fairly admits he cannot state the amount."

The court noted that at the date of the administration, the claim contained hardly any detail and had not been properly articulated. Whilst the claim was ascertained, it was unliquidated because in order for it to be established, HMRC would need to show that the arrangements were a sham and there would also need to be a determination of the real value of the image rights for which the players were "paid". In those circumstances, HMRC could not "fairly put a figure" on the claim and the debts were unliquidated.[19]

HMRC's further argument was that the subsequent assessments (which had been served by the date of the meeting) meant that the only reasonable decision of the chairman was to allow the claims in full. This argument was rejected by the court. Mann J pointed out that HMRC could have removed this difficulty if they had served the assessments, which gave rise to a defined liability, by the relevant date (the date of the administration), which it had not.[20]

HMRC v Maxwell[21]

HMRC's claim here included unpaid corporation tax in connection with the use of EBTs. However, at the date of the administration, there was only an enquiry by HMRC. After the company entered administration, HMRC issued notices of amendment under the Finance Act 1998, which had the effect of requiring the company to amend its self-assessment on grounds that it understated the amount of tax due.

HMRC valued its debt at £8.7 million. The chairman valued it at £609,000 but admitted £1.5m for voting purposes as a gesture of goodwill. HMRC voted against but the proposals were carried. On appeal HMRC argued, again, that it would have been possible as a matter of arithmetic to calculate how much corporation tax was owed and that its claim was therefore liquidated and ascertained.

The Court of Appeal disagreed. Referring to *Re Dummelow* it held that to ascertain the value of the claim, HMRC would have to investigate the law in relation to EBTs, trawl through the figures and carry out calculations by reference to the accounts (which were not straightforward). The debt only became liquidated and ascertained once HMRC had issued notices of amendment.[22] Importantly, however, the court also held that a chairman can take into account events that have occurred since the date the company entered administration when valuing the debt for the purposes of voting at the meeting of creditors.[23]

The Court of Appeal accepted that HMRC had made out a clear prima facie case that the tax it claimed was owing was due, whereas the administrators had simply denied liability in the most general terms.[24] The court therefore ordered that another meeting be summoned.

Conclusions to be drawn from the case law

There appears to be little doubt about the principle. Where an assessment or an amendment notice has been served, the debt will be liquidated and ascertained (even if it is disputed). However, where an enquiry has been opened, but no assessment or notice has been served by the relevant date, then arguably, in light of *Portsmouth* and *Maxwell* the debt will be unascertained or unliquidated.

How do these decisions apply to APNs?

The APN, which gives rise to the obligation on the taxpayer to pay the disputed tax to HMRC, can properly be characterised as giving rise to a debt which is both liquidated and ascertained in amount. It is ascertained because its quantification does not depend on the happening of some future event and it is liquidated because it is for a fixed and defined amount. The amount is a sum that an officer of HMRC has determined is payable to the best of his knowledge and belief.[25] HMRC can therefore "fairly" put a figure on the claim.

Therefore, if an APN has already been given to the taxpayer, it appears that there would be virtually no scope to argue that the debt was unascertained or unliquidated, such that the chairman should value it at £1. If the APN is disputed by the taxpayer, the most likely result is that the chairman will mark the debt as objected to but admit it in full for voting purposes.

What difference would it make if an APN had not yet been served? If it does make a difference, there would be an incentive on individuals who are likely to be affected by the provisions to try and enter into an IVA before being given a follower notice or APN.

There would be scope for arguing that the debt was unliquidated or unascertained if there was still just an enquiry underway at the relevant date, following the reasoning in *Portsmouth* and *Maxwell* (although not if there was an outstanding appeal, in which case there will be a dispute over a defined amount). But even if there was only an enquiry at the relevant date, it would be very surprising if a chairman valued HMRC's debt at £1. This is because in most cases, there will have been a relevant judicial decision confirming the scheme in question involves a denied tax advantage. Also, if a claim is unascertained then the chairman must, pursuant to r.5.21(3), still seek to place a value on it: *National Westminister Bank Plc v Yadgaroff*.[26]

There is a slight difference in relation to APNs issued on the basis that the taxpayer has used a DOTAS scheme (as opposed to the other two bases available under the FA 2014, namely, that a follower notice or a GAAR counteraction notice has been given[27]) because in such cases, it is not necessary for there to have been a judicial ruling in respect of the scheme in question. However, the result is likely to still be the same. The APN itself gives rise to a statutory debt which is liquidated and ascertained in amount. Any arguments disputing the claim are likely to be treated by the chairman as falling within r.5.22(4) and the claim is most likely to be allowed in full.

Similarly, if a follower notice and APN have been issued after the relevant date but by the time of the meeting, in the light of the Court of Appeal's reasoning in *Maxwell*, the chairman would be entitled to take this into account and the most likely outcome would be that the claim would be admitted in full.

So in cases where HMRC has more than 25 per cent in value of the total indebtedness admitted for voting purposes (which is likely to be the case in the majority of IVAs), the existence of a follower notice and APN will almost certainly mean that HMRC will have the final say on whether the proposals are carried.

Thus, where advice is being given to individual debtors who are likely to be affected by the FA 2014 and who are contemplating entering an IVA, the position of HMRC must be looked at very carefully as its willingness to support to IVA will be key to whether the proposals are carried.

[1] Finance Act 2014 s.208(5).

[2] FA 2014 ss.208(2) and 209(2).

[3] FA 2014 s.223 (2)–(3).

[4] FA 2014 s.222(2).

[5] *Re Continental Assurance Co of London Plc (in liquidation)* [2007] 2 B.C.L.C. 287; [2001] B.P.I.R. 733 at [281].

[6] *Re William Hockley Ltd* [1962] 1 W.L.R. 555; (1962) 106 S.J. 308 Ch D.

[7] *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc* [2013] UKSC 28; [2013] 1 W.L.R. 1408; [2013] Bus. L.R. 715.

[8] *Eurosail* [2013] UKSC 28; [2013] 1 W.L.R. 1408 at [31].

[9] *Byblos Bank SAL v Khudhairy* (1986) 2 B.C.C. 99509; [1987] B.C.L.C. 232 CA (Civ Div) at 247.

[10] *Eurosail* [2013] UKSC 28; [2013] 1 W.L.R. 1408 at [37].

[11] Insolvency Rules 1986 r.5.21(3).

[12] IRs r.5.22(4).

[13] IRs r.5.23(2).

[14] IRs r.5.21(2).

[15] There are identical provisions in relation to company voluntary arrangements are there are in relation to IVAs (rr.1.17–1.20).

[16] *Re Portsmouth City Football Club Ltd (In Administration)* [2010] EWHC 2013; [2011] B.C.C. 149; [2010] B.P.I.R. 1123.

[17] These are payments a player is entitled to receive for the use of his image in publicity and other material. PAYE and NIC are not payable in respect of such payments.

[18] *Re Dummelow Ex p. Ruffle* (1872-73) L.R. Ch. App. 997 CA in Chancery.

[19] *Re Portsmouth City Football Club* [2010] EWHC 2013; [2011] B.C.C. 149; [2010] B.P.I.R. 1123 at [90].

[20] *Re Portsmouth City Football Club* [2010] EWHC 2013; [2011] B.C.C. 149; [2010] B.P.I.R. 1123 at [91].

[21] *HMRC v Maxwell* [2010] EWCA Civ 1379; [2011] Bus. L.R. 707; [2012] B.C.C. 30.

[22] *Maxwell* [2010] EWCA Civ 1379; [2011] Bus. L.R. 707; [2012] B.C.C. 30 at [58]–[59].

[23] Applying *Re Law Car and General Insurance Corp (No.2)* [1913] 2 Ch. 103 at 116–117, 122–123 and giving the example that if the debt is a claim for damages, which had yet to be determined at the date of the administration, but before the meeting had been assessed by the court or agreed, the debt would still be treated at the meeting as unliquidated or unascertainable but absent "very unusual circumstances" should be accorded a value equal to the assessed or agreed figure (at [54]).

[24] *Maxwell* [2010] EWCA Civ 1379; [2011] Bus. L.R. 707; [2012] B.C.C. 30 at [65].

[25] FA 2014 s.221(3).

[26] *National Westminister Bank Plc v Yadgaroff* [2011] EWHC 3711 (Ch); [2012] B.P.I.R. 371.

[27] FA 2014 s.219(4).

Personal Insolvency Law in 2015: an Overview of the Current State of Play and Future Likely Developments

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Debt relief orders; Individual voluntary arrangements; Personal insolvency

The statistics

The figures for the calendar year 2014 show how the personal insolvency profile in England and Wales, in terms of the usage of legally sanctioned procedures, has changed in recent years. Individual voluntary arrangements (IVAs) have now assumed the role of the dominant debt resolution procedure,[1] with bankruptcy and debt relief orders (DROs) vying for second place in the popularity stakes. The 2014 figures for England and Wales, which were released by the Insolvency Service on January 29, 2015,[2] show a total of 99,196 personal insolvencies in 2014, which represents a drop of 1.8 per cent on the previous year. This total is made up of 52,190 (IVAs), 26,688 (DROs) and 20,318 (bankruptcies). Both bankruptcy and debt relief orders are down (17.3 per cent and 3.1 per cent respectively), though the lead DROs have over bankruptcy is widening. IVAs have increased 6.8 per cent on the previous year. Of these procedures both the IVA and the DRO are exclusively options designed for the benefit of debtors and, moreover, we must remember that the majority of bankruptcies these days are debtor-induced. This confirms that the collective personal insolvency procedures now operating in English law are primarily debtor-focused. Creditors, do enjoy limited rights of veto, but increasingly are looking to other legal mechanisms to recover debt through non collective procedures and are frequently selling on distressed debt in order to rid themselves completely of the problem of recovery.[3] This is the downside of any liberalisation tradition of personal insolvency law reform. Creditors will respond strategically if they feel that collective procedures are operating against their interests.

Legislative framework

The key legislation governing collective personal insolvency procedures in English Law is located in Pts 7A, 8 and 9 of the Insolvency Act 1986, as amended.[4] The secondary rules are contained in the Insolvency Rules 1986 (as amended).[5] These legislative structures were set in place nearly 30 years ago in the wake of the Cork Report,[6] and although they have been upgraded in the intervening years, they are beginning to show their age, particularly as they were constructed on the basis of the socio-economic conditions prevailing in the 1970s. There is only so much that can be done via an incremental process of amendment. Sometimes radical rethinking is required. We are