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# RECOVERY


# Tax

**President's column** The incoming R3 president sends a strong message

**Unbending the insolvency rules – part 2** Your complete guide to CVL and deemed consent

**Coordination and balance** A look at UNCITRAL's Working Group V on insolvency

**How taxing is tax?** Navigating the tricky waters of tax in an administration

**Risks and opportunities** Why you sometimes need to bring in advisers on tax

**Closer to the edge** How new tax relief changes will affect distressed businesses

**An interview with… Kathryn Hiddleston** How the relationship between IPs and HMRC has changed

**The fees regime so far** How the fees regime has affected smaller practices

**Compensation orders: a quiet revolution** An uncertain area of law put under the magnifying glass

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# From the editor

What will happen in Europe (including the UK) on 26 June 2017? The answer is that the majority of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) will take effect. Catherine Burton explains on pages 16 to 18 how the Recast European Insolvency Regulation will affect European cross-border aspects of UK insolvency proceedings. At the heart of the regulation is mutual recognition of insolvency proceedings throughout Europe. As our new president, Adrian Hyde, observes on page 7, automatic recognition of UK insolvency appointments and court judgments should be a key goal of the government's Brexit negotiators. Without the recast EIR or the automatic recognition Adrian demands, the UK restructuring profession will be seriously disadvantaged. Our Cross-Border Insolvency Regulations 2006 provide for UK recognition of foreign IPs without requiring reciprocity, while most European jurisdictions have no similar provisions. The risk is that in cross-border insolvencies, COMI-shifts away from the UK might become popular!

Legislation and its unintended consequences is a recurring theme in this issue of *RECOVERY*. Sarah Paterson ponders on pages 32 to 34 the incoherence that compensation orders under the Company Directors Disqualification Act, offering remedies for particular creditors, brings to a civil liability regime that rests on loss to the company. Christina Fitzgerald *et al* explore on pages 35 to 37 the decision-making complexities introduced by the Small Business Enterprise and Employment Act 2015 and the Insolvency (England and Wales) Rules 2016. The deemed consent procedure, its thresholds and time limits are a challenge to professionals, but to ordinary creditors they are red tape run riot! On page 44 Chris Herron challenges the tick-box mentality behind the current fees regime, introduced by the Insolvency (Amendment) Rules 2015. Why is it that all these rules not only fail to promote creditor engagement but achieve the opposite? Would it help to have an IP on the Insolvency Rules Committee?

The theme of this issue is tax and the message from the articles on pages 20 to 27 is that it bears more consideration, in all its forms, than IPs sometimes manage. Although HMRC was unable to write for us due to election purdah, our interview with Kathryn Hiddleston of R3's Tax Working Group on pages 47–48 reveals the impact that the R3-HMRC dialogue has had in recent times. Constructive government engagement is also revealed in Frances Coulson's explanation of the work of R3's Fraud Group on page 45.

For those who need even more technicalities and enjoy the interaction of trust and insolvency law, James Hannant on page 10 and Kathryn Maclennan on page 31 look at cases from the High Court, Court of Appeal and Supreme Court that should help to satisfy you over the summer!

**CHRIS LAUGHTON** is editor of *RECOVERY* and a partner at Mercer & Hole.

# Regulars



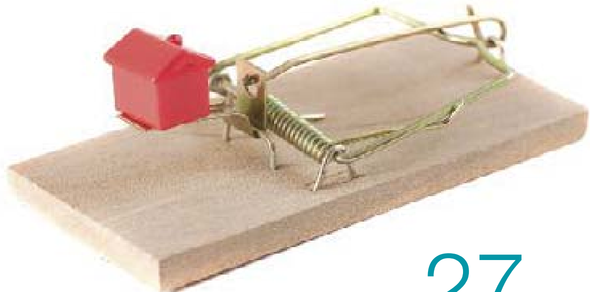
47

# Legal update



# Tax





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22

20

# R3 matters



# Advertising feature



Themes of *RECOVERY* 2017

**AUTUMN** **Regulation**
**WINTER** **Avoiding insolvency (turnaround)**

# Features







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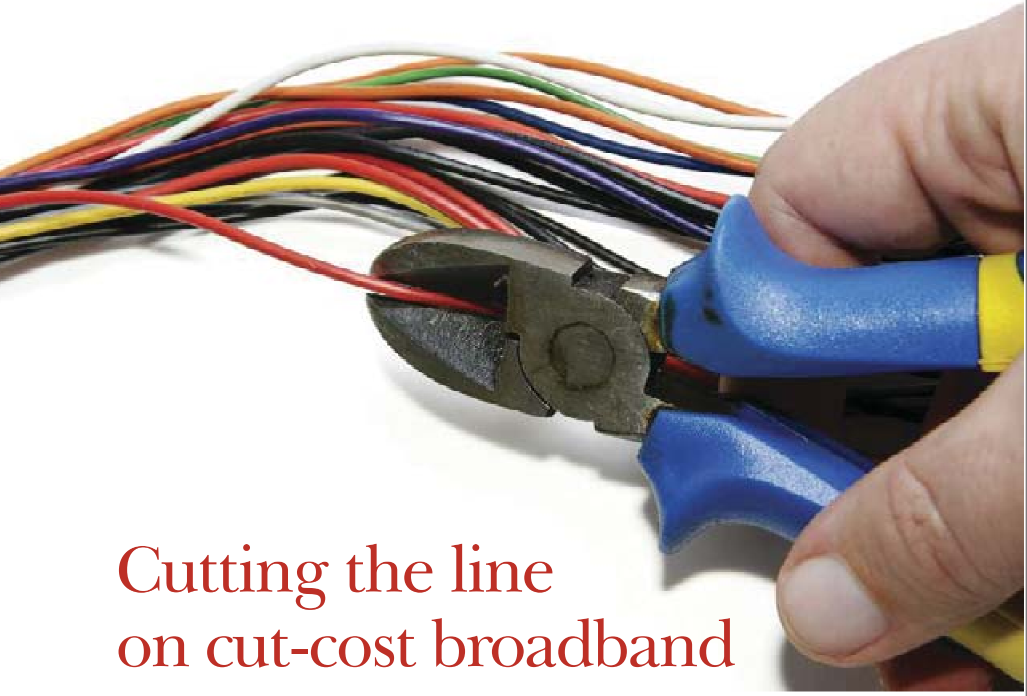

# Cutting the line on cut-cost broadband

Low-cost broadband provider TenTel has gone into administration after failing to secure funding for planned expansion and development. The company has ceased taking on new customers and is due to close at the end of June 2017.

Existing customers will be transferred to rival telecoms provider TalkTalk, keeping their existing contracts and rates with the new provider. Joint administrators from FRP Advisory have been appointed. TenTel, founded in 2013, had an estimated customer base of 10,000 and served as a wholesale partner for TalkTalk, meaning that most of TenTel's customers were already supplied by TalkTalk.

According to a press release on uSwitch, customers will experience no disruption to services or billing during the changeover. It has not yet been determined what will happen to the company's staff.

*Source: uSwitch*

# Charity survives administration

A charity specialising in drug and alcohol abuse services has survived administration with no jobs lost. Lifeline Project ran around 70 services across the UK focused on drug and alcohol rehabilitation. Administrators were appointed from FRP Advisory to explore options for the charity when financial pressure threatened to close it down. It is thought that cuts to the public expenditure budget and poorly funded projects are to blame for the financial distress of Lifeline, which had a turnover of almost £62m last year.

All 1,300 jobs will be preserved as the majority of services and staff transfer to another charity, Change, Grow, Live (CGL). An estimated 80,000 people a year use Lifeline's services, including those in prisons and young offender institutions. The transfer to CGL should not affect the running of those services.

*Source: The Guardian*

# Steely resolve at British Steel

The business that emerged from the Tata Steel administration in Scunthorpe has delivered a healthy £47m in profit EBITDA after its first year. British Steel was formed when turnaround investor Greybull bought the troubled steelworks for a nominal £1 fee last year. Tata Steel remained in control of its plant at Port Talbot.

The company relaunched on 1 June 2016 with a £39m investment from Greybull. The investor also asked all 4,800 employees to take a three per cent pay cut (which has now been reversed). In the year prior to the takeover, the steelworks had made a £79m loss. So far British Steel has already supplied materials for the Crossrail project in London, as well as working on construction projects such as Anfield football stadium in Liverpool.

To celebrate the return to profitability, Greybull has given employees at British Steel a five per cent stake in the business. Roland Junck, executive chairman of British Steel, stated that the workers were responsible for the profits and were 'remarkable people who have embraced, engineered and led change'.

*Source: The Telegraph*

## Property problems

A Dundee real estate company has gone into administration after failing to meet its financial commitments. Fordlane Limited operated a portfolio containing 16 residential properties and one commercial unit in the Dundee area.

The company has no employees and just one current director, Paul Letley. Administrators from RSM had determined that the company was unable to meet its financial commitments and released a statement that the business could no longer continue to trade.

## Company falls at the fence

A small equestrian supplies stand that grew to be a major online retailer in the UK has gone into administration following cash flow difficulties. Equestrian Clearance Warehouse Ltd, which traded as **Equestrian.com**, has ceased trading and made the majority of its 12 staff redundant.

Administrators from KPMG have been appointed and are now looking for a buyer for the business and its assets. The company, founded by Lorraine Meadowcroft, had been a sponsor of several major equestrian competitions and events and had won awards for its customer service.

*Source: Horse and Hound*

## Lancashire still home for textiles

A Lancashire-based group of textile manufacturers, of which one has been operating since 1878, has been sold out of administration, rescuing around 100 jobs. Cliq Designs, JH Cunliffe & Company, Bolton Textiles and Inhome Soft Furnishings, with bases in Bolton and Rochdale, went into administration due to increased competition and reduced sales margins. Joint administrators were appointed from RSM, who then sold the companies to the newly formed Bolton Textiles Group.

*Source: Insider Media*


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# President's column

**Adrian Hyde** lays out his plans for the year amidst the backdrop of Brexit negotiations and a general election.

For the second year in a row, the start of a new R3 'presidential' year has been swiftly followed by a significant national vote: last year, Andrew Tate spent his first few weeks as R3 president getting to grips with the implications of leaving the EU for the UK's insolvency and restructuring framework; my first few weeks as R3 president have been spent with an election looming.

However, whereas the EU referendum pitched us all into the unknown, there is a pretty clear 'to-do' list for the new government – as we heard at last month's Annual Conference in Dublin. The real interest this time has been whether the last government could win a renewed mandate, or whether they would slide back into a coalition. At the time of going to press just before polling day, the polls are wildly swinging back and forth, but now it's time for coalition negotiations to begin.

## R3's Annual Conference

First and foremost, I would like to say thank you to all those who came along to the conference, a thank you to everyone who helped put it together, and a thank you to the speakers and panellists who gave up their time to take part.

Dublin gave us the opportunity to hear some outside views of our profession: from Simon Jack, the BBC's business editor, we heard that Barclays chief executive Jes Staley regards the UK's insolvency and restructuring framework as one of the best in the world.

And, with our panels on corporate insolvency reform and Brexit, we heard thoughts and recommendations from our profession about what the government will need to do over the next few years to make sure the UK's insolvency and restructuring framework – and, by implication, the economy as a whole – is ready for the UK leaving the EU. More on that later.

## My year as president

The Annual Conference also gave me the opportunity, as R3's new president, to set out what I want to focus on over the next 12 months.

Whatever our specific role within the insolvency and restructuring profession, we work across a vast range of sectors, offering support to businesses and individuals at all stages of financial difficulty. Our skills set as a profession is both broad and adaptable.

Andrew, in his year as president, looked at the way our profession's work has been changing and I'm going to pick up where he left off. It's really important that there is a greater understanding of the full scope of our profession's work – both inside and outside the profession – and that R3 reflects everything we do. Whether you work in insolvency, restructuring, advisory, or turnaround, R3 has something to say to represent you.

Over the past 20 years, I've been developing my personal specialism: the fight against fraud.

Our profession has a key role in tackling fraud, whether it's investigating it, disrupting it or helping bring money back to victims. I've seen first-hand the misery that fraud can cause through vulnerable, and not so vulnerable, sections of society and the difference our profession can make.

> "Over the past 20 years, I've been developing my personal specialism: the fight against fraud."

R3 promotes our profession's fraud work through our Fraud Group, chaired by Moon Beever's Frances Coulson, and I'm going to build on the group's work to promote a really positive message about the profession and what we do to support business, individuals, government, and the economy and society as a whole (you can read more about the Fraud Group's work on page 45). As government agencies face budgetary constraints, our role can expand to fill the gap that they cannot.

And last but not least, it will be my role to battle for the profession and make sure our voice is heard over a crucial 12 months. We've already had plenty of change to deal with in the last few years – fees, insolvency procedures, and the Insolvency Rules have all changed significantly since I became R3's deputy vice-president in 2015 – but further reform may be needed to keep our insolvency and restructuring framework ahead of the competition.

Indeed, this was one of the key messages from Dublin: with the countdown clock to Brexit ticking, the new government needs to hit the ground running to make sure our restructuring and insolvency framework maintains its cutting edge. At the same time that the UK risks seeing new barriers to cross-border insolvency and restructuring work, other European jurisdictions are improving their insolvency and restructuring tools – and without a competitive and effective insolvency and restructuring framework, the economy will be held back.

## Post-election 2017 – what now?

Further change is necessary, particularly in order to prepare for Brexit, and R3 will have an important role to play in making sure that any reforms enhance the UK's insolvency and restructuring framework and do not undermine it.

The government's corporate insolvency reform package, for example, could make a difference if the right changes are made to the proposals. Unfortunately, for the time being, these reforms have been put on hold by the election, while there are concerns the government won't have the legislative time available to make changes before the UK leaves the EU.

It's important, however, that the government treats planning for life after the EU as having the same importance as negotiating the UK's exit. The government's development of an 'industrial strategy' is an example of this kind of approach – and creates an opportunity for the government to promote the benefits of individuals and businesses in financial trouble seeking early advice – and it's vital that the government sees corporate insolvency and restructuring reform in the same way.

At the same time as ensuring our domestic legislation is ready for the post-Brexit world, the government needs to make sure existing advantages of EU membership are replicated: automatic recognition of UK insolvency appointments and court judgments across the EU should be a key goal of the government's negotiators.

By the time I hand over the R3 presidency to Stephenson Harwood's Stuart Frith in 12 months, I hope we will have seen much-needed progress from the government. ◻

**ADRIAN HYDE** is president of R3 and a partner at CVR Global.

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# Legal Q&A

## Mark Davies answers your insolvency queries.

**Q I am the liquidator of a company that had a beneficial interest in shares held on trust by a trustee. After commencement of the winding-up, the trustee transferred the shares to a third party in purported settlement of a debt that the trustee owed personally to the third party. Is that transfer a void disposition pursuant to s127 IA 86?**

A Section 127 of the Insolvency Act 1986 (the Act) holds that *in a winding up by the court, any disposition of the company's property, and any transfer of shares, or alteration in the status of the company's members, made after the commencement of the winding up is, unless the court otherwise orders, void.*

The matter at hand in your case is whether the transfer of shares could be considered a 'disposition' of the company's property under s127 of the Act, after the commencement of winding up.

In *Akers and others* v. *Samba Financial Group* [2017] the UK Supreme Court was asked to consider, in the context of proceedings brought by Saad Investments Co Ltd, in liquidation, (SICL) and its joint official liquidators (the liquidators) against Samba Financial Group (Samba), the question of what constitutes a 'disposition' for the purposes of s127 Insolvency Act 1986.

The original proceedings related to the ownership of shares in five different Saudi Arabian banks, of a total value of around $318,000,000. The legal owner, Mr Maan Al-Sanea (Mr Al-Sanea), a citizen of Saudi Arabia, also acted as chairman and was the ultimate beneficial owner of SICL, a company incorporated in the Cayman Islands. In a series of six transactions between 2002 and 2008, Mr Al-Sanea transferred the shares to SICL and created a series of trusts but retained the legal title in order to comply with the legal requirements of Saudi Arabia, whose laws do not recognise the institution of a trust. In July 2009 SICL went into liquidation following which, in September 2009, Mr Al-Sanea transferred all of the Saudi Arabian shares to Samba.

The liquidators and SICL brought proceedings against Samba, which sought a declaration under s127 of the Act that the transfer of shares by Mr Al-Sanea in September 2009 was a void disposition of the property of SICL. In reaching their decision, the Supreme Court looked primarily at whether s127 of the Act should apply in the circumstances, before giving some consideration to the concept of property in a common law trust where a jurisdiction does not legally recognise such an institution.

All three Supreme Court Justices found, for varying reasons, that there had been no 'disposition' of SICL's property. Lord Mance reasoned that s127 was *'neither aimed at nor apt to cover'* the transfer of equitable interests which continued to exist in the shares despite the transfer of legal title. Interestingly, although the case was decided on the basis of there being no disposition under s127, the Supreme Court also commented that the Hague Convention on the law applicable to trust and on their recognition (the convention) would apply in principle to this claim. Samba had unsuccessfully argued it should not on the basis that Saudi Arabian law does not recognise the institution of trusts.

**Q I am the trustee of a bankrupt in whose sole name the matrimonial home was registered and who was responsible for making all the mortgage payments. The bankrupt and spouse are both arguing that they beneficially owned the property in equal shares. The spouse is further arguing entitlement to a charge on the bankrupt's share in the property since the borrowing was for the purposes of the bankrupt's business – the equity of exoneration. Would the argument that the spouse benefitted indirectly from the loan, as it enabled the bankrupt to continue in business and meet the mortgage payments, overcome the spouse's argument?**

A This is a fundamental question of whether couples should be treated separately in law where one stands surety for the debt of the other, and one that the courts have recently re-considered in *Armstrong (As Trustee in Bankruptcy of Andrew Obinna Kalu Onyearu)* v. *Onyearu and Another* [2017], where the Court of Appeal was asked to consider the principle of equity of exoneration in respect of an application for possession and sale.

The property in question was the matrimonial home and was registered in the sole name of Mr Onyearu who also had responsibility for making all of the mortgage payments. In 2005 Mr Onyearu obtained a loan facility from the bank, which was secured against the matrimonial home, and which was used to pay debts of his solicitor practice totalling £131,642. On 3 March 2011, Mr Onyearu was declared bankrupt and an application was brought by the trustee in bankruptcy for the sale of the property. Mr and Mrs Onyearu argued that they beneficially owned the property in equal shares, which was accepted by the deputy registrar who accordingly dismissed the application for possession and sale.

The deputy registrar found that Mrs Onyearu was entitled to a charge on her husband's share in the property applying the principles of equity of exoneration in respect of the loan facility and that the banks security exhausted Mr Onyearu's beneficial interest.

The trustee, Mr Armstrong, appealed, relying heavily on the argument that, although the loan facility was directly for the benefit of Mr Onyearu in respect of his business debts, Mrs Onyearu had obtained an indirect benefit as the loan facility had enabled Mr Onyearu to continue to practise as a solicitor and meet the monthly mortgage.

On considering the arguments, the Court of Appeal dismissed the appeal on the grounds that the indirect benefit obtained by Mrs Onyearu was too remote to displace the evidential presumption that Mr Onyearu was to bear responsibility for repayment of this loan. Lord Justice David Richards also identified that Mr and Mrs Onyearu did not operate as a single financial unit and maintained their own separate bank accounts and incomes, despite sharing the family expenses. Accordingly, Lord Justice Richards considered that denying Mrs Onyearu relief under equity of exoneration would result in her paying both her share of the expenses and Mr Onyearu's, which is contrary to the notion of equity.

The decision of the Court of Appeal not to change the law is in keeping with existing trends that seek to allow couples to retain a separation of their financial affairs in so far as they desire. ◻

**MARK DAVIES** is an insolvency partner at Aaron and Partners LLP.

# Recent case summaries

Latest insolvency update from **James Hannant**.

## PERSONAL INSOLVENCY

***Abdulla* v. *Whelan and others* [2017] EWHC 605 (Ch)**

The decision in *Abdulla* v. *Whelan and others* [2017] EWHC 605 (Ch) addressed the effect of the disclaimer provisions in the Insolvency Act 1986 (IA) where one of two or more joint tenants is declared bankrupt.

The bankrupt (B) was a joint tenant of business premises (the property) held under an underlease (the underlease). B's trustee in bankruptcy (T) served a notice of disclaimer in accordance with s315 IA, thereby disclaiming all interest in the property. On advice from counsel, T took the view that the notice of disclaimer did not end the legal estate in the underlease and therefore the bankrupt's estate remained liable for rent in respect of the property.

> A trustee in bankruptcy cannot disclaim the legal interest in a lease held jointly by the bankrupt and another person.

This was not accepted by the husband of B (who also claimed to be a creditor) and T sought directions from the court.

At first instance the district judge held that the disclaimer had the effect of preventing the landlords from proving for rents due after the date of the notice of disclaimer. On appeal, Mr John Male QC (sitting as a deputy judge of the High Court) upheld the first instance decision and held that even where the bankrupt was one of the beneficiaries of a trust, the existence of the trust meant that the legal interest in the property did not vest in the trustee and could not therefore be disclaimed.

The court observed that the tenants held the underlease as joint legal owners on trust for themselves. The legal estate in the underlease was vested in the bankrupt and the co-owner as trustees for themselves. S283(3)(a) IA had the effect of excluding from the bankrupt's estate property held on trust for any other person. Accordingly, the underlease was excepted from the property comprised within the bankrupt's estate and remained at all times in the names of the bankrupt and the co-owner.

Under s315 the trustee can only disclaim property comprised in the bankrupt's estate. The legal estate in the underlease was not vested in the bankrupt's estate and could not be disclaimed:

*'… a trustee in bankruptcy cannot disclaim something which is not in his ownership. Further, and in any event… any step taken in relation to trust property, such as a disclaimer in relation to the legal estate in the underlease, would need to be taken by the two trustees acting together.'*

Further, the appellant could not rely upon the decision in *Hindcastle Limited* v. *Barbara Attenborough Associates Limited* [1997] AC 70 that the court should take a more flexible approach to the disclaimer and not be bound by the strict property law approach relied upon by the trustee and the landlords. Unlike in *Hindcastle*, the effect of the insolvency legislation was clear and it was not necessary to find a solution to any conundrum because Parliament had determined that property held on trust (such as the bankrupt's legal estate in the underlease) was to be excluded from a bankrupt's estate.

The decision provides useful confirmation that a trustee in bankruptcy cannot disclaim the legal interest in a lease held jointly by the bankrupt and another person.

## CORPORATE INSOLVENCY

***Akers & Others* v. *Samba Financial Group* [2017] UKSC 6**

In *Akers & Others* v. *Samba Financial Group* [2017] UKSC 6 the Supreme Court addressed the question of whether a transfer by the legal owner of the legal estate, which is subject to an equitable interest, to a bona fide purchaser for value without notice of that equitable interest is a disposition for the purposes of s127 IA.

Mr Al-Sanea held shares of around $318m (£245m) on trust for Saad Investments Co Ltd (SICL). Following SICL's entry into liquidation, Mr Al-Sanea transferred the shares to Samba Financial Group (Samba) thereby discharging personal liabilities that he owed to Samba. SICL and its joint liquidators contended that the share transfers were void dispositions within the meaning of s127 IA.

In the Court of Appeal and below the 'critical issue' had been identified as being whether SICL had equitable proprietary interests in the shares. However, the main issue before the Supreme Court was whether SICL had any basis for alleging that there was a disposition of property within the meaning of s127.

The Supreme Court observed that the definition of 'property' in s436 IA was broad enough to encompass equitable proprietary interests and purely personal interests. While it was arguable that the misappropriation of assets subject to a trust, or the destruction or an extinction of an equitable interest in those assets constituted a 'disposition', that analysis did not fall within the natural meaning of 'disposition' in the context of s127, which Lord Mance held 'refers to a transfer by a disponor to a disponee of the relevant property'.

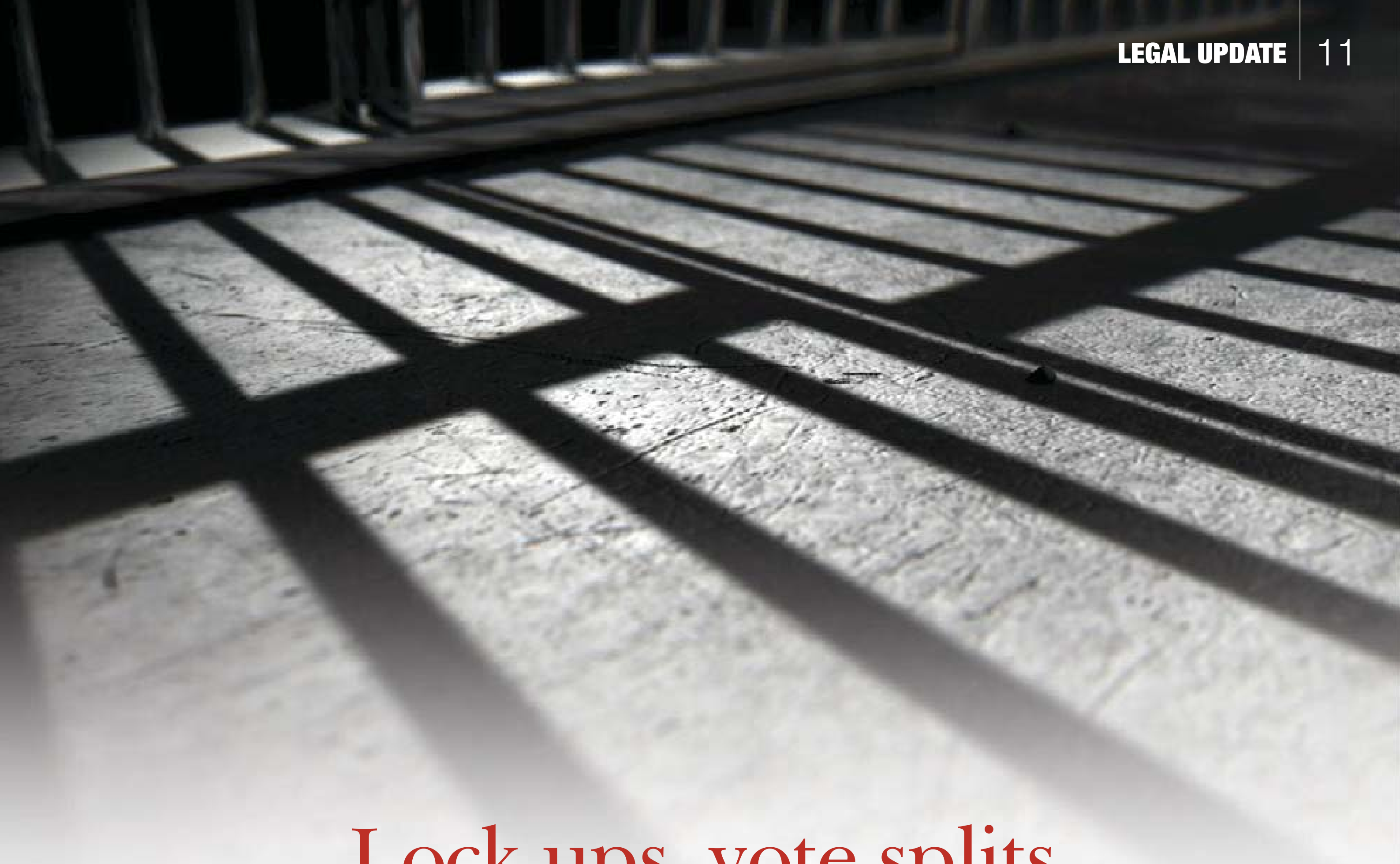
> Where assets are held on trust, the legal interest can be transferred but the trust rights remain.

The court went on to observe that, where assets are held on trust, the legal interest can be transferred but the trust rights remain. If the trust rights are overridden, this is not a result of the transfer of legal title. It is because those rights were always limited and in certain circumstances capable of being overridden by virtue of a rule of law governing equitable rights, protecting in particular bona fide third-party purchasers for value.

The court found it to be material that the holder of an interest such as SICL's did not need the protection provided by s127. SICL's interest (however characterised) continued, despite the disposal of the legal title, unless and until that disposal overrode it. If the disposal overrode SICL's interest it was because SICL's interest was always limited in this respect.

The decision is of interest because it expressly limits the applicability of s127 IA in circumstances where a trustee holds an asset on trust for the company, and the trustee transfers it to a third party in breach of trust. But going beyond that, the decision also provides an authoritative analysis of the operation and effect of s127 IA. □

**JAMES HANNANT** is a barrister at Guildhall Chambers.



# Lock ups, vote splits and matters of jurisdiction:

## further developments in relation to schemes of arrangement

**Joe Bannister** examines instances of conflicting grounds for jurisdiction and creditor/shareholder support of English schemes.

The Companies Act scheme of arrangement – now set out in part 26 of the Companies Act 2006 (CA 2006), has come a long way. Long gone are the times when schemes of arrangement – never an Insolvency Act process – were merely seen as tools for implementing solvent reorganisations. Schemes of arrangement are nowadays one of the most favoured means for rescheduling, reorganising or otherwise compromising the liability of companies to their creditors in complex multi-jurisdictional restructurings.

English schemes are popular because of the breadth and flexibility of the legislative provisions and their low jurisdictional threshold. Additionally, the courts take a robust and pragmatic approach to the proponents and opponents of the part 26 process. This article summarises four examples of that pragmatism in action.

### Conflicting grounds for jurisdiction

English courts have taken jurisdiction for considering part 26 schemes on differing grounds. Two cases illustrating that difference are *Re DTEK Finance PLC* [2016] EWHC 3563 (*DTEK*) and *Re Global Garden Products Italy SpA* [2016] EWHC 1884 (*GGP*). The former is a decision of Norris J while the latter is a ruling of Snowden J. *DTEK* involved a company incorporated in England and Wales whereas the subject company in *GGP* was incorporated in Italy.

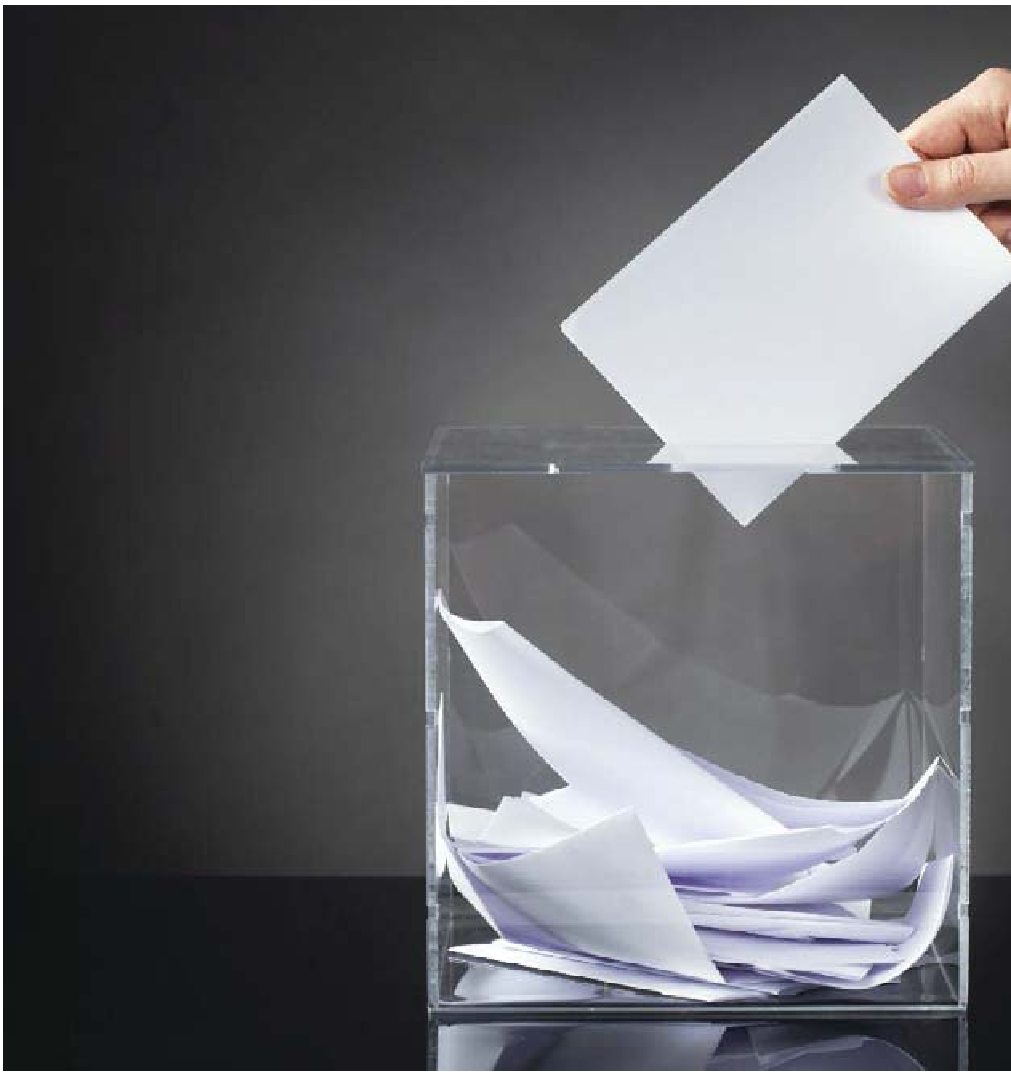
> Long gone are the times when schemes of arrangement – never an Insolvency Act process – were merely seen as tools for implementing solvent reorganisations.

In *GGP*, Snowden J repeated the well-established principle that the English courts may sanction a scheme in relation to any company that is liable to be wound-up under the Insolvency Act 1986 (IA 1986). Snowden J went on to repeat the well-established rule that the 'liable to be wound-up' threshold the courts apply extends to a company incorporated outside England and Wales. There are two principal matters to be shown. The first is that there is a reasonable possibility of creditors benefitting from the scheme process. Additionally, the court must be satisfied that one or more persons interested in the distribution of the company's assets are persons over whom the English courts can exercise jurisdiction. Snowden J found these requirements were satisfied in *GGP*. In *DTEK*, this test was inapplicable given *DTEK's* incorporation in England.

More contentious is the basis upon which the courts claim jurisdiction over scheme creditors. This is particularly so for schemes in respect of European companies. The European Insolvency Regulation is inapplicable to schemes. However, it is unclear whether chapter II of the recast EU Judgments Regulation (No. 1215/2012) applies to schemes of arrangement. In order to avoid determining this question, the courts have, on a number of occasions, assumed that the recast regulation applies. It governs 'civil and commercial matters'. It is also » inapplicable to bankruptcy or winding-up proceedings. The courts have generally accepted that part 26 schemes are *prima facie* 'civil and commercial matters' under the recast regulation.

### Home is where your court is

Article 8 of the recast regulation provides that a person – including a company – domiciled in a member state can also be sued in the courts where any one of a number of defendants is domiciled. The courts' approach is to treat the part 26 scheme as a claim brought against a number of defendants. Hence the courts will take jurisdiction to sanction a scheme where any one scheme creditor is domiciled in England and Wales, and the court is satisfied that claims of the scheme creditors are 'so closely connected that it is expedient to hear and determine them together'.



> Snowden J held that the purpose of a part 26 scheme was to facilitate compromises and to supply a statutory alternative to agreements between a company and its members or creditors. That compromise would allow the prescribed majorities to bind dissentient or absent majorities.

This 'expediency' test has been most controversial. In *DTEK*, Norris J identified two grounds to satisfy it. The first is the desirability of binding all scheme creditors into the same restructuring. The alternative depends upon satisfying the court that there are sufficient creditors in number and value domiciled in the United Kingdom to make the exercise of jurisdiction appropriate.

Norris J declared himself (paragraph 21 of *DTEK*) 'firmly' in favour of the first alternative. Hence he saw it as unnecessary to assess the number and value of creditors domiciled in the United Kingdom as a ground for jurisdiction.

In *GGP*, Snowden J reached the opposite conclusion. He insisted on more specific evidence than hearing scheme creditors holding at least 28.37 per cent of scheme claims by value were domiciled in the United Kingdom. Snowden J only agreed to move forward on receipt of evidence that three of the five creditors referred to were major financial institutions incorporated in the United Kingdom holding between them a little more than 24 per cent of scheme claims. He also drew comfort from hearing that the other two creditors were funds managed by Alcentra Limited and Halcyon Loan Advisors Limited, both of which were companies incorporated in the United Kingdom. Based on that evidence, Snowden J concluded that if the recast regulation did apply, article 8 gave him jurisdiction on the basis that sufficient creditors by number and value were domiciled in the United Kingdom.

Both Snowden J and Norris J agreed that the 'sufficient connection' test referred to above could only be satisfied by evidence that there was sufficient prospect of a scheme being recognised in other jurisdictions where the company operated. In *GGP*, Snowden J received expert evidence that the scheme would be recognised in Italy. In *DTEK*, Norris J sanctioned the scheme on the basis of evidence that it would be recognised in New York as the jurisdiction of a number of the company's creditors.

### 'Lock up' or 'thumbs up?'

Two recent cases have readdressed the two principal means whereby creditors – or shareholders – may support schemes. The first is where creditors – or shareholders – give irrevocable undertakings either to vote in favour of a scheme or to provide written consent to the scheme's terms and implementation. *Re SABMiller PLC* [2016] EWHC 2153 (*SAB*) addressed these questions. Although Snowden J was dealing with a shareholder scheme put forward to enable the takeover of SAB by AB InBev, the scheme proponents – and Snowden J – followed the same rules applicable to creditor schemes. *SAB* is therefore equally relevant to the current round of creditor schemes.

In *SAB*, the two largest shareholders had given irrevocable undertakings either to vote in favour of the scheme or to consent in writing to its implementation. Certain other shareholders, while intending to support the scheme, opposed the company's intention of excluding these two large shareholders from the scheme meetings. Snowden J rejected the shareholders' application. He held that the purpose of a part 26 scheme was to facilitate compromises and to supply a statutory alternative to agreements between a company and its members or creditors. That compromise would allow the prescribed majorities to bind dissentient or absent majorities.

Snowden J went on to say that to make the legislation effective, the courts had to adopt a flexible and purposive approach to part 26 schemes. Snowden J acknowledged (paragraph 30) the risks of excessive sub-division of creditor classes. He identified the principal risks as being that of conferring veto rights on small minority groups. Snowden J went on to say that part

> **Snowden J held that those creditors who signed up to the lock up arrangement and received a fee could go in the same class as other scheme creditors.**

26 did not prevent creditors from voluntarily agreeing to waive or forego their rights to participate in scheme meetings. There was no difference between this and the position of a member or creditor of a company simply deciding against attending and voting at the creditors' meeting.

Snowden J, laid weight upon the fact that neither shareholder was acting under compulsion. He also recognised that the proposed scheme would not operate to confiscate or expropriate the shareholder's rights. There was in consequence no 'legal or practical necessity' to construe part 26 as preventing creditors or shareholders from deciding against taking part in scheme meetings.

In *GGP*, Snowden J also considered 'lock up' agreements. In the *GGP* scheme, the holding company (Topco), two other companies and two credit support providers, Alcentra Limited and Halcyon Structured Asset Management European CLO 2006-11BV (the coordinators) concluded a 'lock up' agreement. Under that agreement, the coordinators agreed to vote in favour of the scheme. That agreement was circulated to other scheme creditors. They were told that if they signed the lock up by a specified date, they would receive payment of a fee of 0.5 per cent of their locked up credit support commitment or claim.

Snowden J held that those creditors who signed up to the lock up arrangement and received a fee could go in the same class as other scheme creditors. Once again, Snowden J focused upon part 26's purpose in facilitating compromises. He pointed out that the 'lock up' arrangements were available to all scheme creditors. He also recognised that the fees were a relatively small amount when compared with the liabilities to be compromised.

### Vote splitting

A part 26 scheme can only proceed if it is approved by a *majority in number* representing *three quarters in value* of the creditors or class of creditor voting in favour of the scheme. In *Re Dee Valley Group* [2017] EWHC 184 (Dee Valley), the English court looked for the first time at the numerosity (majority in value) aspect of the part 26 process. In particular, the court had to consider whether to sanction a scheme where shares had been transferred to sufficient additional shareholders to ensure that the numerosity test was not met. Once again, the *Dee Valley* ruling, although made in a shareholder scheme, could also apply in a creditor scheme.

The key facts in *Dee Valley* were that after publication of scheme documents, one shareholder transferred 443 of his shares to 443 individual shareholders. The purpose was to ensure that the scheme was voted down by a majority in number of the shareholders – in effect employees who opposed the scheme.

Having become aware of these share movements, the company applied to the registrar for a direction that the chair of the shareholders' meeting should be allowed to reject the votes of the new shareholders. The direction was given and the votes were duly rejected. The result was that the scheme was approved. At the sanction hearing, the judge had to consider whether the scheme should proceed.

The judge held that the scheme should indeed be sanctioned. He emphasised that the court responsible for a part 26 scheme had inherent power to direct the way in which meetings were to be held. Provided the chairman did not act perversely or in bad faith, it was unnecessary for him to have a court direction in order to have the power to reject votes.

> **The key facts in *Dee Valley* were that, after publication of scheme documents, one shareholder transferred 443 of his shares to 443 individual shareholders. The purpose was to ensure that the scheme was voted down by a majority in number of the shareholders.**

In the judge's view, the fact the chairman knew of the circumstances in which individual shareholders acquired their shares gave him the evidence necessary to conclude that the votes were not being cast for the purpose of benefitting the class as a whole. This was because, on the evidence, the only possible explanation for the individual shareholders' conduct was the implementation of a share manipulation strategy to defeat the scheme.

As stated above, *Dee Valley* is equally applicable to creditor schemes. This is because the two-tier test applicable under part 26 is open to manipulation and has been criticised on this basis. In that respect, the value of the numerosity test is open to question. Nevertheless, *Dee Valley* at least illustrates the courts' willingness to look critically at its application where significant movements occur in response to the proposal of a scheme of arrangement.

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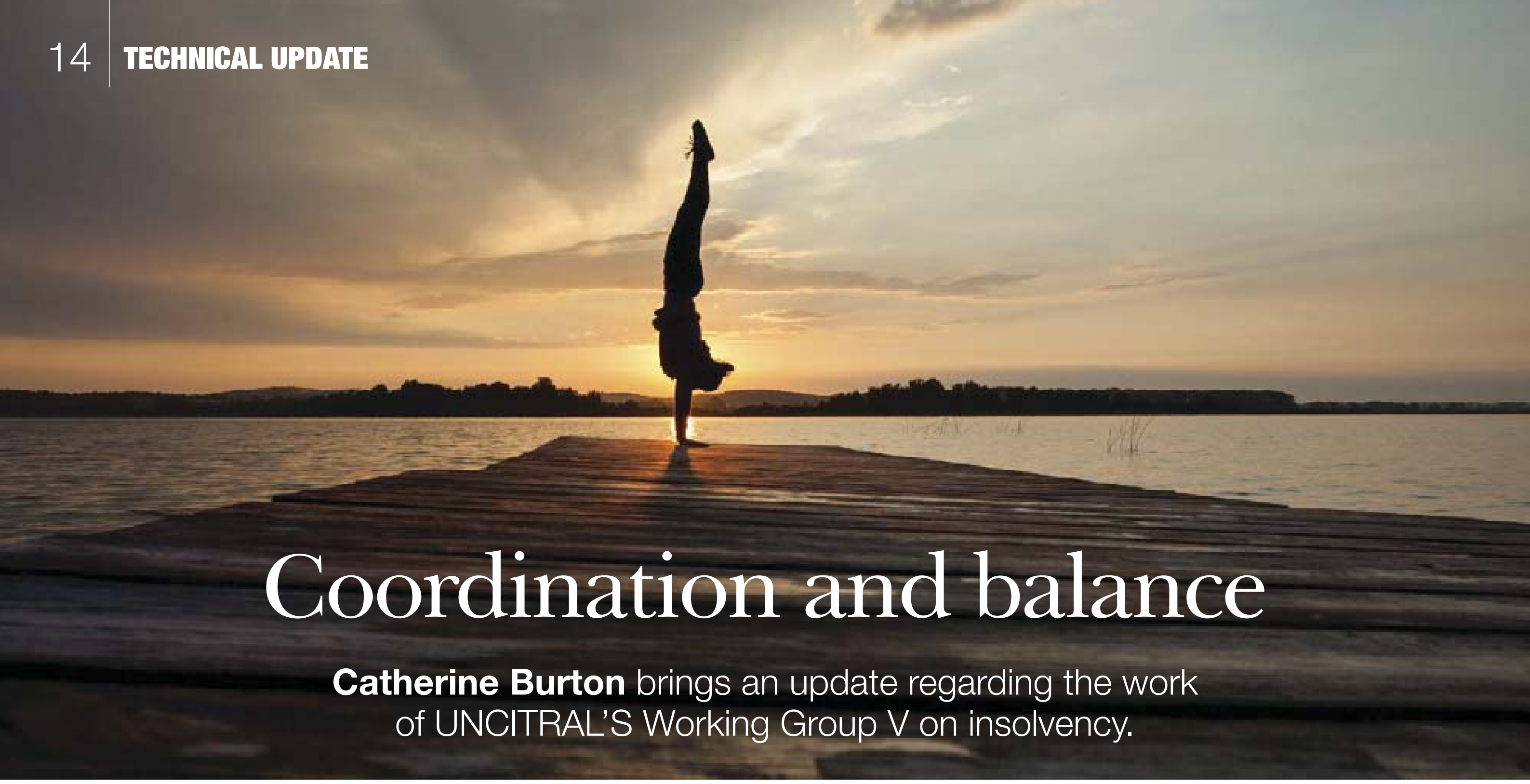

# Coordination and balance

**Catherine Burton** brings an update regarding the work of UNCITRAL'S Working Group V on insolvency.

As reported previously in *RECOVERY* (Summer 2016, p13, Perfect Harmony – also available at **www.r3.org.uk/media/documents/publications/recovery/Summer16.pdf**), for the past few sessions, UNCITRAL's Working Group V on Insolvency (WGV) has been concentrating on three key areas:

- Facilitating the cross-border insolvency of multinational groups;
- Cross-border recognition and enforcement of insolvency-related judgments; and
- (via an informal expert group tasked with examining the issues and reporting to the main group), the obligations of directors of enterprise group companies in the period approaching insolvency (to supplement Part 4 of UNCITRAL's legislative guide).

This article aims to bring you up to date prior to the 51st session of the working group, which is scheduled to be held in New York from 10 to 19 May 2017.

## Cross-border insolvency of multinational groups

WGV aims to agree a set of key principles and draft text for a regime to address cross-border insolvency in the context of enterprise groups (defined widely to mean any entity, regardless of its legal form, that is engaged in economic activities and may be governed by insolvency law). This has started to take a form most suited to a stand-alone supplement to the Model Law. The Group's secretariat produced a draft legislative text, incorporating three principles agreed by WGV. The three principles are:

- coordination and cooperation of insolvency proceedings relating to an enterprise group;
- elements needed for the development and approval of a group insolvency solution involving multiple entities; and
- the use of synthetic proceedings in lieu of secondary proceedings (secondary proceedings being described in the context of UNCITRAL as 'non-main proceedings').

As with the recast European Insolvency Regulation (EIR), the text is designed to encourage cooperation and communication between insolvency practitioners (called 'insolvency representatives' in the draft text) with a view to the better realisation of the group's assets as a whole and, if particularly appropriate, via the commencement of a form of group proceedings. Although the draft text still includes a couple of unhelpful circular definitions, it is taking shape and is now close to being finalised.

> "The text is designed to encourage cooperation and communication between insolvency practitioners (called 'insolvency representatives' in the draft text) with a view to the better realisation of the group's assets as a whole."

Early articles of the legislative text make it clear that it is not intended to limit the jurisdiction of the courts of adopting member states and there are several safeguards throughout the text that reflect this. The text describes its purpose as providing effective mechanisms to address cross-border insolvency and to promote the objectives of:

- cooperation between courts (and other competent authorities);
- cooperation between insolvency representatives;
- development and implementation of a group insolvency solution affecting some or all of the members of an enterprise group;
- fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested parties – notably here, for those in the UK familiar with strong creditor rights, express reference is made to 'including the debtors';
- protection and maximisation of the combined value of the assets and operations of the enterprise group members and group as a whole;
- facilitation of the rescue of financially troubled groups thus protecting investments and preserving employment; and
- adequate protection of the interests of creditors of each group member that participates in a group insolvency solution.

Cooperation between insolvency representatives and courts is facilitated. Participation is currently described in the draft (consistent with other UNCITRAL texts) as being 'to the maximum extent possible'. Examples of the type of cooperation that this might take for courts include: communicating with foreign courts involved in the proceedings of other group members; coordination of the administration and supervision of the affairs of group members; and coordination of concurrent proceedings and appointing a person or body to act at the direction of the court.

The courts may coordinate between themselves with respect to the appointment and recognition of a single, or the same, insolvency representative to administer the proceedings of members of the same enterprise group in different member states. These measures are qualified by draft provisions explaining that participation by a court in communications with other courts does not imply any waiver or compromise by the court of any powers, responsibility or authority, nor any enlargement of any of the courts' jurisdiction.

For insolvency representatives, the draft text suggests that cooperation may take the form of sharing and disclosing information (with measures to protect confidential information), coordinating the proceedings, administration and supervision of the affairs of group members, and coordination with a view to developing and implementing a group insolvency solution.

### Developing a group solution

While the recast EIR anticipates *separate* group coordination proceedings being commenced, UNCITRAL's draft text contemplates that when main insolvency proceedings have been commenced in respect of a member of a group in one state, any other group member may participate *in that proceeding* for the purpose of developing and implementing a group insolvency solution. The draft text explains that participation in this way does not subject the group member to the jurisdiction of the court. It merely entitles it to appear, be heard and make written submissions on matters affecting its interests, as well as to take part in the development of a group solution. Participation is voluntary and can take place at any time.

> The courts may coordinate between themselves with respect to the appointment and recognition of a single, or the same, insolvency representative to administer the proceedings of members of the same enterprise group in different member states.

The definitions, as currently drafted, provide that once one group member joins another group member's proceedings for this purpose, and the court appoints a group representative to that proceeding, it becomes a 'planning proceeding'. The group representative is then authorised to apply to the court for various stays or protection of assets to enable a group solution to be developed, and is given the right to apply to other courts for recognition of the planning proceeding with accompanying relief.

The draft text also includes provision of a form of synthetic secondary proceedings to avoid the commencement of non-main proceedings. In anticipation of the 51st session, the draft text features provision for synthetic main proceedings – so that an insolvency representative of a group member in one member state may, with the court's permission, commit to providing creditors of a group member in another member state with the treatment that they would have received in their home member state. The secretariat's annotations to the draft text highlight that these supplemental provisions are likely to be the subject of significant consideration and debate.

UNCITRAL's draft cross-border group coordination provisions are ambitious. While EU member states automatically become subject to European regulation (unless they have opted out, as Denmark has done) the adoption of UNCITRAL text is purely voluntary. Many UN member states have not yet adopted the Model Law. As they are encouraged to do so with minimal amendment to the core text, it is sensible for these ambitious provisions to be in a separate text – remaining member states should not be discouraged from introducing the original model law.

### Insolvency-related judgments

WGV has also been considering a stand-alone instrument/model law (rather than forming part of the current UNCITRAL Model Law on Cross-Border Insolvency) to provide for the recognition and enforcement of insolvency-related judgments. The principle is clear, but as with all proposed legislation intended to be sufficiently flexible and palatable for introduction throughout UN member states, difficulties arise in determining the detail: what type of judgments should it apply to? Should the law expressly state the types of judgment to which it should not apply? On what grounds should courts be permitted to refuse to recognise foreign insolvency-related judgments? Who should be able to make the application and what procedure should be followed? All these issues are covered by the draft text, but it is clear that, particularly in relation to the definition of what is (and perhaps also, what is not) an insolvency-related judgment, WGV has further work to do before arriving on agreed scope and wording. Until the text is finalised, it would be inappropriate to comment further on its likely scope and in particular to conclude whether, if enacted in the UK, it would give rise to a different result than seen in the Supreme Court's judgment in *Rubin* v. *Eurofinance SA* [2012] UKSC 46.

### Insolvency of MSMEs

As the work of WGV on group proceedings and insolvency-related judgments nears conclusion, the Commission has given it a mandate to consider how best to tailor the mechanisms already provided in the legislative guide specifically to address the challenges faced by micro-, small- and medium-sized enterprises (MSMEs). In anticipation of WGV considering the scope of such work, its secretariat produced a working paper[1] suggesting some of the particular challenges faced by MSMEs and measures taken in various jurisdictions around the world to counter them. The perceived challenges included difficulties in accessing insolvency solutions due to lack of skills to identify and react to financial distress, passive creditors who consider the amount they will be likely to receive from the parties involved not to merit engagement, greater potential for inefficient record-keeping systems, hampering provision to creditors and other stakeholders of relevant information, and insufficient assets to fund insolvency proceedings.

The secretariat suggested that WGV could use some of its time during the May meeting to consider how the proposed work on MSMEs might be developed. The UK currently provides for moratoria-led CVAs for 'small companies' but otherwise its legislation does not expressly provide any insolvency or restructuring solutions specifically designed for MSMEs. The difficulty will always lie in determining where the cut-off point arises. It will be particularly interesting, therefore, for UK practitioners to follow the progress of this next project for WGV.

> The secretariat suggested that WGV could use some of its time during the May meeting to consider how the proposed work on MSMEs might be developed.

These discussions will continue for some time and readers will be aware that UNCITRAL'S proposals lack the force of a legislative body to impose them on member states. Adoption of the Model Law by member states has been slow, and the matters being discussed by the working party are far from reaching a conclusion. This does not mean that the Working Group shouldn't be ambitious in its proposals, but the aim must be to produce a text that is attractive enough for member states to want to adopt but still valuable enough to provide workable solutions.

[1] A/CN.9/WG.V/WP147

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# The power of the collective: EIR in focus

**Catherine Burton** provides an update on the Recast European Insolvency Regulation before many of its provisions apply at the end of June 2017.

As reported in *RECOVERY* Winter 2015 (Technical Update – Europe, is there more to come?) the recast Insolvency Regulation (Regulation (EU) No. 2015/848) (the recast regulation or EIR) was adopted by the European Parliament and Council on 20 May 2015. This article is a reminder of the key changes commencing on or after 26 June 2017. The current EC Regulation on Insolvency Proceedings no. 1346/2000 (ECR) will continue to apply to any proceedings within its scope, commenced before that date.

Those parts of the recast EIR that will not apply on 26 June 2017 comprise member states' obligation to establish and maintain national registers of insolvency proceedings (which will apply from 26 June 2018)[1] and the adoption of legislation to establish a decentralised system to connect each member state's insolvency registers and the European e-Justice Portal (with a deadline of 26 June 2019)[2].

### Scope

The recast EIR continues to apply to all European member states other than Denmark and has been extended in scope to new categories of proceedings, including rehabilitation proceedings, which are set out in annex A. The emphasis remains on collective proceedings and, consequently, the UK's receivership and administrative receivership regimes remain outside the scope of the recast regulation.

"The proceedings should include all, or a significant part, of the creditors to whom the debtor owes a substantial proportion of its outstanding debts, but the claims of creditors not involved in the proceedings must remain unaffected."

Similarly, the UK's scheme of arrangement, falling under the Companies Act 2006 rather than insolvency legislation remains outside the scope of the EIR. This will enable the English courts to continue to apply the flexible 'sufficient connection test' when considering whether to accept jurisdiction over a scheme. The recast EIR excludes confidential proceedings, making it clear in the recitals that, while they play an important role in some member states, their confidentiality militates against two important aspects of the recast EIR: publication in registers and recognition in other member states[3].

The recast EIR's recitals also explain, in wide terms, how 'collective' should be interpreted: the proceedings should include all, or a significant part, of the creditors to whom the debtor owes a substantial proportion of its outstanding debts, but the claims of creditors not involved in the proceedings must remain unaffected. Such proceedings should be aimed at rehabilitating the debtor. Those that result in the cessation of the debtor's activities or liquidation should include all of its creditors.[4] Interim proceedings that meet all other criteria of the recast EIR fall within its scope. The recast EIR continues only to apply to those debtors whose centre of main interests is located within the European Union (thus would include, for example, a company registered in Malaysia but with its centre of main interests (COMI) in France.

### Key changes – COMI and forum shopping

Recital 5 of the recast EIR includes an implied but important acknowledgment of the different types of forum shopping: those where the relevant forum is chosen to make a better return for creditors compared with those where, usually natural persons, seek a regime that they consider to be more favourable for their interests, often to the detriment of their creditors.

COMI-shifting and other devices seeking to maximise returns to creditors will be permitted – within the constraints of new COMI limitations.

### COMI is now expressly defined

Article 3 provides that, for both companies and individuals, the COMI shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. For companies, the registered office presumption remains, but will not apply if the registered office has been moved to another member state within three months prior to the opening of insolvency proceedings. The majority of COMI shifts that have taken place to facilitate better returns for creditors since the introduction of the ECR rely on factual circumstances displacing the registered office presumption. Consequently this provision alone is unlikely to restrict such beneficial forum shopping.

For individuals engaged in business or professional activity, COMI will be presumed to be their principal place of business unless that has been moved to another member state in the three months before applying to open insolvency proceedings.

For all other individuals, their COMI is presumed, in the absence of proof to the contrary, to be the place of their habitual residence. Here, however, the presumption will not apply if that has been moved to another member state within six months of the request to open insolvency proceedings.

> In line with the intention for the recast EIR to embrace rescue and rehabilitation proceedings, it is no longer necessary for secondary proceedings to be liquidation proceedings.

### New standard form

There is to be a standard notice (to be published on the European e-Justice Portal, headed 'notice of insolvency proceedings') that will be issued to foreign creditors by the court or relevant insolvency practitioner as soon as insolvency proceedings are opened in a member state. The notice to creditors must inform them of any time limits for claiming, the body(ies) authorised to accept and adjudicate claims and whether secured or preferential creditors need to lodge a claim. The notice will be accompanied by a standard claim form headed 'lodgement of claims'[5].

### Stays and synthetic secondary proceedings

In line with the intention for the recast EIR to embrace rescue and rehabilitation proceedings, it is no longer necessary for secondary proceedings to be liquidation proceedings. Recital 41 expressly recognises that secondary insolvency proceedings can hamper the efficient administration of an insolvent estate. The regulation therefore sets out two specific situations in which a court seised of a request to open secondary proceedings should be able, at the request of the insolvency practitioner in the main proceedings, to postpone or refuse to open such proceedings.

### Extending the stay

The opening of secondary proceedings may be stayed for a period of up to three months when such a stay has been granted in the main proceedings, provided the court ordering the stay of secondary proceedings is satisfied that suitable measures are in place to protect the interests of local creditors.[6]

### Synthetic secondary proceedings

To avoid the opening of secondary proceedings the insolvency practitioner may give an undertaking that he will distribute assets in accordance with local distribution and priority rules in the jurisdiction where those proceedings could be issued. Under the recast EIR, the insolvency practitioner must specify the factual assumptions on which it is based, including the value of assets located in that member state and the options available to realise those assets. The undertaking must be made in writing in one of the official languages of the secondary member state and must be approved by local known creditors. The approval process for creditors within the secondary member state will replicate the qualified majority, and voting that applies in that state for the adoption of a restructuring plan under its laws. For example, if England were to be the relevant secondary member state, mirroring a CVA, a 75 per cent majority would be required to approve a proposed CVA. The procedure to approve the proffered undertaking therefore takes place largely outside court. There are a number of safeguards to ensure that the insolvency practitioner complies with his undertaking and provision for him to be liable in damages if he fails to do so.

> Perhaps the most significant change introduced by the recast EIR is a selection of measures to facilitate the coordination of insolvency proceedings affecting members of a group of companies.

This convoluted procedure could take several weeks to complete, whereas the timescale for synthetic secondary proceedings via an application to court along the lines previously seen in England, can be much faster. The wording of Article 36 'right to give an undertaking in order to avoid secondary insolvency proceedings' is permissive – 'the insolvency practitioner *may* give a unilateral undertaking', but the recitals that are secondary to the articles of the regulation and used to help to » interpret them suggest, by use of 'two specific situations… in which the court… should be able… to postpone or refuse the opening of such proceedings', create scope for some courts to interpret the undertaking requirements to be mandatory. It remains to be seen, therefore, whether member state courts consider that they have jurisdiction to make orders of the kind formerly seen.

### Location of assets

As with the ECR, the recast EIR provides for the law of the state of the opening of proceedings to determine the conditions for the opening of proceedings, their conduct and closure, but also provides a series of 11 exceptions[7] including rights *in rem*, set off, contracts of employment, pending lawsuits and contracts relating to immovable property. Several of the exceptions depend on the location of the asset in question, for example, rights *in rem* are excepted where the relevant charged asset is situated within the territory of another member state[8]. The recast EIR's definitions article[9] seeks to clarify the location of various assets so that, for example, in the case of security over shares, the registered shares in companies are deemed to be situated in the same member state where the company that issued the shares has its registered office.

### Coordination of group insolvencies

As previously discussed in *RECOVERY*[10], perhaps the most significant change introduced by the recast EIR is a selection of measures to facilitate the coordination of insolvency proceedings affecting members of a group of companies[11]. Article 2 defines 'group of companies' as a parent undertaking and all its subsidiary undertakings. Section 1 of chapter V to the recast EIR imposes a duty on insolvency practitioners appointed in respect of different members of a group of companies, and the courts that open the insolvency proceedings in respect of those members, to cooperate with each other 'to the extent that such cooperation is appropriate to facilitate the effective administration of those proceedings, is not incompatible with the rules applicable to such proceedings, and does not entail any conflict of interest.'[12] It is expressly anticipated that cooperation may take any form but might include the use of agreements or protocols.

The adventurous part comes with the introduction of 'group coordination proceedings'. An insolvency practitioner appointed in relation to a member of a group of companies has a right to be heard in any proceedings opened in respect of any other member of the group. He is also entitled to request the opening of group coordination proceedings before any court which has jurisdiction over the insolvency proceedings of any member of the group[13]. His request to open group proceedings must be accompanied by a proposal for the person who will be nominated to act as 'group coordinator'[14]. That person must be eligible under the law of at least one member state to act as an insolvency practitioner but not already be acting as an insolvency practitioner of any of the members of the group and must not have any conflicts of interest in respect of members of the group, their creditors or other insolvency practitioners appointed[15].

The group coordinator's role will be to make recommendations for the coordinated conduct of the insolvency proceedings and to propose a 'group coordination plan' that will ideally set out measures to be taken to restore the financial health of members of the group.

> "An insolvency practitioner appointed in relation to a member of a group of companies has a right to be heard in any proceedings opened in respect of any other member of the group."

The court seised of the application to open group coordination proceedings will not do so nor notify all insolvency practitioners appointed in respect of each member unless it is satisfied, *inter alia*, that the opening of group proceedings is appropriate to facilitate the effective administration of the insolvency proceedings relating to different members of the group and that no creditor or any group member expected to participate in the group proceedings is likely to be financially disadvantaged by its inclusion in the proceedings. Insolvency practitioners notified of the proposed group proceedings affecting the group member to which they have been appointed, have 30 days from receipt of the notice requesting the opening of the group proceedings to object to the inclusion of their company in the group coordination proceedings or to object to the person proposed as coordinator. When a member of a group has objected to being included, they will not be responsible for any part of the costs of the coordination proceedings (which will be divided between the remaining members of the group). However it is possible for a group member who has objected to the proceedings or one whose own insolvency proceedings commenced after the commencement of the group coordination proceedings to decide to opt into the coordination proceedings at any time.

The division among members of the group of the coordinator's costs is to be proposed by the coordinator. Insolvency practitioners have 30 days to object, failing which the costs will be deemed to have been agreed. Any objections must be made to the court that opened the coordination proceedings. Its decision is challengeable in accordance with the procedures set out under the laws of the member state in which that court is located.

Where a restructuring plan is proposed for some or all of the members of the group, an insolvency practitioner appointed to one or more group members can be heard in any proceedings affecting other group members, without seeking the formal opening of group coordination proceedings. The practitioner may request a stay, initially for three months, extendable to a maximum of six months, of 'any measure related to the realisation of the assets' of other group members. Their request can only be made, and the stay ordered, if the court is satisfied that:

- a restructuring plan has been proposed and presents a reasonable chance of success;
- the stay is necessary to ensure the proper implementation of the plan; and
- the plan would benefit creditors in the proceedings in which the stay is requested.

The court hearing the application for a stay may require the insolvency practitioner to take any suitable measure available under national law to guarantee the interests of creditors in the proceedings.

### Conclusion

The recast EIR seeks to address many of the perceived shortcomings of the original ECR. Some of its provisions are adventurous and it will be particularly interesting to see the extent to which the new measures for synthetic secondary proceedings and group coordination proceedings are embraced. ◻

1 Article 24
2 Article 25
3 Recitals 12 and 13 thus excluding, for example, French mandataire ad hoc and conciliation proceedings
4 Recital 14
5 Article 53
6 Recital 45 and Article 38
7 Articles 8–18
8 Article 8
9 Article 10
10 *RECOVERY* Summer 2016 Perfect Harmony.
11 Chapter V
12 Article 56 and similar wording appears in Articles 57 and 58
13 Article 60
14 Article 61
15 Article 71

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# Risks and opportunities

**Marcus Rea** explains what a tax adviser needs from an IP and what tax issues can arise in insolvency.

Tax law and interpretation are constantly moving and deals are not static exam questions. Distressed and stressed business situations need deep knowledge and fast-thinking, commercially oriented tax people at the table from the start.

Tax advisers need to get involved in transactions early, digest their client's commercial needs, consider possible outcomes and then, together with the IP, engage with stakeholders to promote sensible solutions that will get the best value deal over the line.

This article sets out some of the key areas that an IP should consider with their tax adviser – whether in their role as prospective administrator or liquidator, or as the company's financial adviser guiding them through a restructuring. Being aware of the range of issues should help IPs gauge when to bring their tax team on board.

### Understanding the deal

Tax advisers often tell IPs to get them involved in transactions early. Prompt access to information affords time to plan and gives advisers the best opportunity to manage tax incurred on a transaction, as well as future taxes that may be suffered either in insolvency or by the rescued business.

Many companies that reach the point of restructuring or insolvency will be loss-making. It is therefore not completely unreasonable for many IPs to start from the premise that tax will be irrelevant. In practice that is rarely true.

It is vital that the tax adviser understands the commercial dynamics of the deal from the outset. A compromise of lenders in a scheme of arrangement will be very different to a compromise of landlords in a CVA, a pre-packaged sale of the business in administration, a wind down in liquidation or any variant of these themes. Each has different tax consequences and presents different opportunities and risks.

> "Distressed and stressed business situations need deep knowledge and fast-thinking, commercially oriented tax people at the table from the start."

Understanding the deal dynamics helps the tax adviser target key concerns. For example, this can be done by identifying and, where possible, mitigating the tax consequences of one-off releases or adjustments that could otherwise derail a deal, or by preserving tax shelters, which will be critical to cash flow in the turnaround period. Or it could be determining whether transactional taxes (such as stamp duty land tax or withholding taxes) are in point. Cross-border issues, if relevant, can complicate matters further.

It will also help to focus on the important pre-transaction steps necessary to get the company ready to actually transact – from simple collation of critical information to support the required outcomes to packaging up the business that is to be sold (for instance, freeing a sub-group from a web of inter-company debts).

Understanding the deal also equips the tax lead to potentially identify simpler and more efficient ways of achieving those same outcomes – getting better value not only for their client, but for the other stakeholders – which can be the difference in getting the deal done.

### Understanding the background

Whether a transaction involves a disposal of business and assets through an insolvency, or is a restructuring involving a one-off compromise with creditors, it's not unusual for large gains or taxable credits to arise. If these occur post-appointment or in an ongoing company, there is a reasonable chance that any resulting tax bill will need to be settled but for the existence of losses or access to exemptions.

A useful starting point is the most recent tax computations or estimates, and knowing to what date the company's tax affairs have been agreed with HMRC. These may help identify what latent tax costs might arise and what accumulated tax attributes are available to shelter them (losses of various guises, capital allowance pools, etc).

If the company's tax affairs are not current, it may be useful to make a quick assessment of any material 'missing' period tax attributes. If losses are not required to shelter taxable income on the transaction, in an insolvency situation it may be possible to agree those missing periods on a no profit/no loss basis. Conversely, if they are key to mitigating a current tax charge, an estimate should be made of the attributes generated in that interim period and, in due course, the gaps should be filled by filing returns.

> "A useful starting point is the most recent tax computations or estimates, and knowing to what date the company's tax affairs have been agreed with HMRC."

The position has been complicated by the recent introduction of limitations on the use of carried forward losses. From 1 April 2017, only 50 per cent of a company's taxable income in excess of £5m can be sheltered by losses carried forward from previous periods. If an insolvency or restructuring results in one-off exceptional income, tax is now much more likely to become payable. There is some hope that the government will agree exemptions to this rule for restructuring transactions. It currently seems unlikely that any leeway will be granted for insolvency. Unfortunately, at the time of writing, civil servants are observing 'purdah' pending the forthcoming election and it is likely to be the autumn before we discover more.

Generally, having some insight into what historical issues might have been raised by HMRC, and the quantum of any exposure, can feed into the assessment of whether a company can be saved in its current form, what form of 'rescue' will offer best value and ultimately whether an insolvency process is unavoidable. This review should be broader than corporation tax and encompass a company's indirect tax compliance, for instance in respect of VAT and PAYE.

Tax is a cost like any other and time-to-pay (TTP) arrangements can be a lifeline for businesses facing cash flow difficulties. However, where a TTP exists, how and when to keep the Revenue in the loop is an important consideration. If TTP instalments have been missed, early engagement is wise. Any chance of avoiding HMRC issuing personal liability notices (PLNs) on officers of the company for unpaid PAYE, NIC or VAT and/or commencing winding-up processes itself, must be worth pursuing.

### Understanding the red flags

Where the transaction includes a compromise with a company's creditors, it will be important to clarify the tax treatment of any credit arising from a release or substantial modification of debt.

The UK has a useful but carefully defined suite of exemptions to support 'rescue' situations. Affecting a release via a scheme of arrangement or CVA should be exempt, as should one arising from a capitalisation of the debt (assuming carefully implemented).

The more recently introduced corporate rescue exemption for releases was designed to offer greater flexibility where, but for that rescue transaction, there was a material risk that the company concerned would be unable to pay its debts as they fell due within the next 12 months. It is inevitably a subjective test – though whether the exemption should apply is likely to be self-evident in the majority of cases. Nevertheless there will be circumstances where it warrants further consideration (for instance, can a transaction be said to meet the 12-months condition if the debts aren't due for more than a year?).

Seeking a non-statutory clearance from HMRC that these exemptions are applicable provides certainty but also adds delay (particularly where a clearance can only be sought when the transaction mechanics are largely agreed).

The tax adviser must also consider the impact of an insolvency and what steps the IP is likely to take. Realisations from assets or compromises with creditors may trigger significant one-off taxable adjustments. And the fact that a new period of account arises on the appointment of the IP can impact on how losses are used to shelter that income. Tax groupings may be broken and 'going concern' conditions may no longer be met (even in an administration that aims to rescue the business!), cutting off access to various reliefs. If the insolvency of a non-UK-incorporated company is contemplated, IPs should take particular care of UK tax exposures as HMRC reserve the right to pursue an IP personally in the event of UK tax being left unpaid by those companies.

### Understanding the upsides

If a company's trade has dramatically declined (perhaps because of some unexpected external shock), it is not uncommon for a terminal loss relief (TLR) claim to be a major asset in the company's insolvency. If sufficient losses have been made in the last 12-month period of trading, this potentially allows an IP to seek a refund of corporation tax that was paid in any of the three years immediately preceding that final year.

Assessing this against current outstanding tax liabilities (including PAYE and VAT) will determine whether a TLR claim is still worth pursuing given HMRC's rights of crown set-off. And knowing whether there is a VAT group will, for instance, allow the IP to know if outstanding liabilities cover a single company or are joint and several across a number.

Alternatively where all or a part of a business will survive, preserving the tax attributes that are taken forward with it can make a real difference to stakeholder returns in the turnaround period. Considering the value placed on plant and machinery (or other eligible fixed assets) will determine whether a successor inherits a pool of capital allowances. Elections to lock-in capital allowances on a sale to a third party must be signed by the company's proper officer – so a receiver may struggle to broker a good deal and regret that the appointment had not taken the form of a liquidation or administration. In some cases it may be worth exploring opportunities to hive down trade and assets into a new subsidiary company (the shares of which will be sold). This can help in a variety of ways – for example by preserving larger capital allowance pools than might otherwise carry over to a purchaser through allocation of consideration.

> "From 1 April 2017, only 50 per cent of a company's taxable income in excess of £5m can be sheltered by losses carried forward from previous periods."

It is worth remembering that losses can be forfeit on a change of ownership under the anti-loss-buying legislation, which needs to be carefully considered.

### Understanding the opportunity

Tax should rarely be the determining factor as to whether insolvency or rescue are necessary. It will, however, very often be key to how a transaction should be implemented in order to retain value for existing stakeholders. Commercial, pragmatic tax advisers by the IP's side can smooth that process and make an enormous difference to what those stakeholders can expect.

**MARCUS REA** is a partner specialising in tax in the restructuring services team at Deloitte LLP.

# Closer to the edge

**Gemma France** examines the impact on distressed companies of changes to tax relief for interest costs and losses.

New restrictions to tax relief for interest costs and the use of tax losses are set to apply from 1 April 2017. Distressed businesses and their stakeholders will face tough decisions as the impact of these changes starts to hit cash flow, asset and deal values.

The general election has paused the progress of the proposed changes through Parliament. HM Treasury has in principle committed to 'legislate for [these] provisions at the earliest opportunity, at the start of the new Parliament'. Other political parties could take a different approach. This article assumes the changes will be enacted this autumn as set out in the finance (No 2) bill 2017, with effect from 1 April 2017.

> From 1 April 2017, where group net interest costs exceed £2m, tax relief is limited to 30 per cent of tax-adjusted EBITDA.

The R3 Tax Committee has been in discussion with HM Treasury and HMRC to highlight the impact of these rules on business rescue and turnaround, in the hope that amendments may follow to lessen the downsides for distressed businesses.

### Relief for interest costs cut

*The 30 per cent fixed ratio restriction:* from 1 April 2017, where group net interest costs exceed £2m, tax relief is limited to 30 per cent of tax-adjusted EBITDA.

*An alternative 'group ratio' restriction:* recognising that there are some companies whose activities justify higher borrowing, more heavily leveraged groups can elect into an alternative restriction based on the worldwide group ratio of interest to EBITDA. See box below for more details.

Interest relief that is denied can be carried forward and reactivated in later periods if there is capacity to use it. In principle, companies with low profits or losses should be able recover their relief in the turnaround years and beyond. Surplus capacity to use interest relief can also be carried forward – in this case for up to five years.

> Many distressed companies will find that tax relief for interest only rolls up while they remain overleveraged – offering only a distant hope of relief for what is ultimately a real economic cost.

Companies who are consistently overleveraged and struggle to reduce that burden are unlikely to see any benefit from carry-forward mechanisms. Many distressed companies will find that tax relief for interest only rolls up while they remain overleveraged – offering only a distant hope of relief for what is ultimately

### More than 30 per cent? Accessing the more generous 'group ratio restriction'.

- In practice it may be difficult for distressed companies to confirm whether they can access this more generous group ratio rule, because 'related party' debt cannot be used to justify higher earnings, and the definition of 'related party' is complex.
- Broadly, consolidation of results, participation in management, control, or 25 per cent common investment makes a debt 'related party'. Holdings are aggregated between connected persons or persons 'acting together'. A number of exceptions are available.
- Debt that has only become 'related party' as a result of the borrower being taken under the control of their lender(s) on a debt for equity swap is not treated as 'related party'. Corporate rescue conditions must be met – ie, without that swap it would have been unable to pay its debts within 12 months. This is good news for companies and lenders who have undertaken rescues of this kind over the past five to ten years.
- Where banks have taken equity in a borrower but are unaware (and could not reasonably be expected to be aware) that they have become 'related' to the borrower when they advance additional lending, this will not be treated as 'related party'. In principle this is a good idea from the perspective of banks who run their equity and lending teams separately. However, it is unclear how HMRC would expect a bank to meet this test or evidence that it has been met – further guidance is needed.
- Guarantees can bring third-party debt back within the 'related party' definition, as an indicator of 'excessive' leverage. However a guarantee can be ignored where:
  – it is given prior to 1 April 2017;
  – it is provided by a group member;
  – it is a share or loan pledge in respect of the group; or
  – it is a performance guarantee (ie, a non-financial guarantee provided in respect of obligations to provide goods or services).
- Given all of the above, distressed companies may struggle to confirm whether this more generous group ratio rule will apply. That is tough, when such businesses are generally overleveraged for economic rather than tax-motivated reasons, and may be unable to attract anything other than expensive debt finance until well into the recovery phase.

a real economic cost. One-off exceptional restructuring adjustments may also materially distort the restriction.

There are also practical difficulties in insolvency. Information gathering will be difficult where records are poor or out-of-date.

Once in insolvency, companies do not generally prepare statutory accounts. Particularly in pre-appointment periods, where there is no cash to pay unsecured claims, the costs of preparing detailed accounts are often not justifiable. Insolvency practitioners may struggle to work out the impact of these changes, prepare the papers and agree the necessary group allocation arrangements without significant additional work.

### Tax losses restricted

Companies that have suffered losses during a downturn in fortunes have historically been able to rely on these to shelter all of their profits in the turnaround period, only facing cash tax once those losses are exhausted.

From 1 April 2017, companies and corporate groups can use tax losses brought forward to shelter up to £5m of profits each year in full, but only 50 per cent of their profits above that level.

> "From 1 April 2017, companies can use tax losses brought forward to shelter up to £5m of profits each year in full, but only 50 per cent of their profits above that level."

Most types of tax losses are covered by the new rules: trading losses; management expenses; financing losses; and property losses. Capital losses are not affected.

For companies or groups expecting or experiencing £5m profit per annum turnarounds, this means cash tax arising as soon as they start to realise those profits, a delay in using their tax losses, and a real impact on transactional values.

Banks have already been suffering similar restrictions to their ability to use losses incurred in the financial crisis. This restriction is also being further tightened from 1 April 2017 to 25 per cent of taxable profit (down from 50 per cent).

### New losses will be more flexible

On the plus side, tax losses arising from 1 April 2017 will be more flexible than before. Existing restrictions around the carry forward of losses are lifted, permitting the offset of one type of loss against another type of profit, and between group companies.

This increased flexibility will be a benefit to the next generation of distressed companies and those whose turnaround is still a year or more away.

However, this will be little comfort today to those who have already suffered large pre-April 2017 losses and are facing an accelerated tax bill and a longer wait for relief. Those with a mixed portfolio may also find some frustration in this new two-tier system: post-April losses will be available to shelter next year's profits anywhere in the group; but pre-April losses carried forward cannot be used until that particular part of the business turns a profit, however long that takes.

A new terminal carried-forward loss relief allows any trading losses that prove to be surplus on cessation, to be used without restriction to shelter total profits in the final 36 months of trade. However, under the new rules, losses that prove surplus at cessation must not have been capable of being used when first carried forward through those same periods. So on the face of it, this new terminal loss relief adds little to the package.

One-off exceptional restructuring adjustments could materially distort the loss restriction and deny tax relief for real economic costs, at the worst possible time for the business and its stakeholders. By way of example:

- A retailer suffering high rents, on store leases negotiated at the peak of the market, accrues a £20m onerous lease provision, and takes tax relief. Being in distress it is unable to use that relief immediately and carries forward £25m tax losses.
- It later seeks a compromise of landlords via a company voluntary arrangement. This triggers a one-off £25m release of the onerous lease provision.
- The company can now only shelter £15m of the release with losses (ie £5m + 50 per cent x £20m). Taxable profits of £10m arise, and at today's tax rate of 19 per cent, £1.9m of cash tax must be paid. The company carries forward £10m of losses but may not survive to use them. If this £1.9m tax charge tips the economics of the planned CVA to a point where the business is no longer viable, the rescue fails – pushing the company into insolvency.

A one-off impact like this could mark the difference between creditors supporting a rescue package or stakeholders walking away.

Again, there are practical difficulties for companies in insolvency. Information gathering will be difficult. Tracking pre- and post-April 2017 losses may be impossible where records are poor or out of date.

Anti-loss buying rules have been strengthened and the new group-wide flexibility has been carefully limited to ensure that these opportunities are not exploited.

These rules could be triggered by changes of ownership, major changes in the nature or conduct of a trade or investment business, and intra-group transfers of assets. Existing anti-avoidance rules have been extended, and a targeted anti-avoidance rule neutralises any 'arrangements' to circumvent these rules.

> "One-off exceptional restructuring adjustments could materially distort the loss restriction and deny tax relief for real economic costs, at the worst possible time for the business and its stakeholders."

Strengthening anti-avoidance and limiting scope is clearly an important factor in making the increased flexibility of these changes affordable for the Exchequer, but it brings complexity and an increased risk of disruption to commercial restructurings.

### Closer to the edge

Changes to tax relief for interest costs and tax losses are likely to result in increased tax liabilities. Extra cash demands will push distressed companies closer to the edge. More rescue deals – and earlier – will be needed to avoid business failures.

Companies and investors alert to these changes should model their impact on deal values, identify pinch points, manage covenant obligations and stakeholder expectations, and plan ahead. This will be critical for cash management. Those of us who work in business rescue day to day will be working to smooth that path, and ensure our clients know how to spot value and emerge successfully from these challenges.

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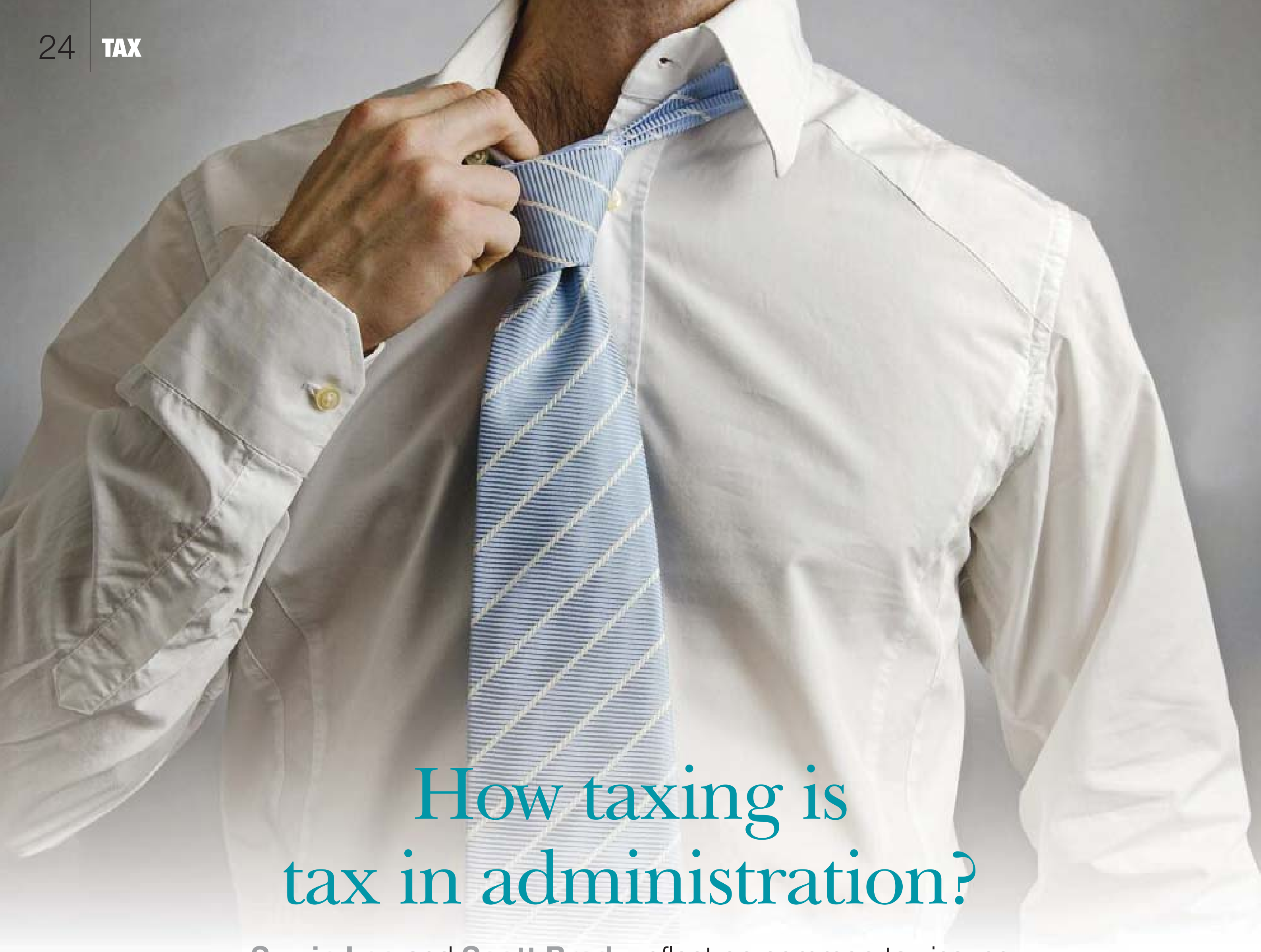

# How taxing is tax in administration?

**Suwin Lee** and **Scott Brady** reflect on common tax issues that impact a trading administration.

When a UK (or overseas) company enters UK administration, and continues to trade in the short term, a number of UK corporate tax, stamp tax and VAT considerations need to be reviewed by the administrators.

In practice, the actual tax implications of any administration will be specific to the facts of that appointment. To help you navigate some of the complexities, let's explore some of the more common issues to be mindful of. These are split into the lifecycle of the process, ie the appointment itself, trading in administration and then the sale of assets. The tax consequences of any release or restructuring of inter-company or third-party debt in the UK are not covered as this subject alone is worthy of an article!

### Does ranking matter?

As a starting point, the ranking of tax in the order of distributions for administrations is likely to be a key consideration and may impact how much focus is given to tax. So, as a reminder, tax arising post appointment is an expense of an administration process, while tax arising pre appointment is an unsecured creditor. However, the extent to which any post-appointment tax liability is actually settled will then depend on whether the income to which it relates is fixed charge or floating charge (and then by reference to the relevant ranking of tax liabilities in the creditor waterfall).

> "Most tax groups are formed by reference to beneficial ownership and control and they can be impacted by the appointment of an administrator."

### Initial appointment considerations

Before we consider what happens on appointment, let's pause for a moment and reflect on the risk that a non-UK incorporated company may also be considered to be UK tax resident if it is 'managed' from the UK post appointment. Where a company is managed will be driven by a number of factors, including where decisions are made, what those decisions relate to and who makes them. It is not a simple process.

Why does this matter? Well, a migration of tax residency to the UK may lead to local territory tax exit charges or increase the overall tax charge that applies to income or gains in the administration. This could lead to additional tax leakage.

If we now concentrate on companies that are UK tax resident, the commencement of an administration starts a new tax accounting period for corporate tax. The general practice is that this period continues (and tax returns are submitted) for a period of 12 months each time, or until the company ceases to trade or enters liquidation (if earlier).

Most tax groups are formed by reference to beneficial ownership and control, and they can be impacted by the appointment of an administrator. It is a critical point for you to clarify as it may impact the availability of the company in administration to benefit from losses in the wider tax group and/or tax exemptions. Helpfully, a chargeable gains group should not be impacted.

### Talk to the taxman

For VAT, HMRC should be notified of the appointment within 21 days and the responsibility for the accuracy of the declaration lies with you. The impact on an existing VAT group or registration, particularly if the whole VAT group is not put into administration, should also be reviewed.

The appointment creates a new VAT return period, effective on the date of appointment. A point that is often overlooked is that you are responsible for the entire day of appointment, ie the day is not apportioned. There is also a switch from electronic VAT returns to paper VAT returns – welcome to the end of digitalisation!

As a new VAT period is created, there is no recovery of pre-appointment input tax on post-appointment VAT returns. The business is responsible for submitting any pre-appointment VAT returns but, if you choose to submit these returns on behalf of the business, they should not be signed (and it should be clearly stated that the return has been *'completed from the books and records of the company'*).

> "Tax is taxing and administrations make it more so."

For stamp taxes, on the basis that beneficial ownership of the assets does not change when a company is placed into administration, the appointment of an administrator should not cause a stamp taxes group to be broken up. This matters as assets (within the charge to UK stamp taxes) can then still be transferred intra group and continue to benefit from stamp taxes group relief. However, if the placing of a company into administration is regarded as a change of control, this may trigger a clawback of certain reliefs under stamp duty land tax (SDLT) or land and buildings transaction tax (LBTT) to arise[1].

### Trading in administration

Capital allowances (tax depreciation) continue to be available in the trading period. As assets (on which capital allowances have been claimed) are sold there is an adjustment to the capital allowance pool(s) to reflect this.

Further, if there is a cessation of trade, any capital allowance pool is deemed to be sold for its market value on the last day of trade. This may hinder or help you. It may create additional taxable income if a balancing charge arises (where proceeds exceed the pool value), but could provide much needed additional tax shelter if a balancing allowance arises (where proceeds are less than the pool value).

Brought forward losses may be available to shelter taxable income in the administration period. There is now more flexibility in the use of carried forward losses (incurred post 1 April 2017). However, new loss restriction rules apply to restrict the amount of profit that can be offset by brought forward losses (these do not apply to capital losses). When a company in administration finally ceases to trade, any unused trading losses can then be carried back up to 36 months from the date of cessation of the trade. This could give rise to a repayment of tax previously paid.

In general, other income and gains continue to be taxed as normal during an administration. The corporate tax returns then need to be prepared using 'reasonable' accounts (it is generally assumed to be by reference to an accruals basis). Practically, this may require some adjustments by you to the receipts and payments accounts.

As is often the case, it may be that if pre-appointment tax returns are not filed with HMRC, you may need to consider the benefit of preparing these if you want to rely on and utilise any brought forward tax attributes to shelter any post-appointment taxable income. This may also involve the need to resolve pre-appointment open tax audits. This will be driven by the cost and benefit analysis.

### Sale of assets

The purchase price allocation across the assets of any commercial deal will impact the tax treatment of the sales proceeds.

If chargeable assets are sold, a chargeable gains calculation will be necessary. This broadly takes the disposal proceeds and subtracts the original cost as adjusted for inflation. In practice, it may be difficult to evidence the original purchase price and date of acquisition if company records are not maintained and you may need to engage in discussions with HMRC to agree any assumptions made.

The availability of the UK substantial shareholding exemption (SSE) to shelter any gains on disposal of shareholdings would also need to be considered. The SSE is not available for the sale of assets.

Any current assets (for example, stock, debtors etc) that are sold above their carrying value in the accounts may give rise to taxable income if they are sold for more than book value.

The VAT returns must report income from the sale of assets. The sales of the shares of a business is an exempt supply and no VAT is charged on the sale. If the sale is by way of an asset disposal, it may qualify as a VAT free transfer of a going concern (TOGC). The treatment as a TOGC is mandatory if a number of conditions are met so it is important to confirm if this applies.

> "For VAT, HMRC should be notified of the appointment within 21 days and the responsibility for the accuracy of the declaration lies with you."

On cessation of trade, the company should be deregistered and HMRC will issue a final VAT return. This is typically only done when there is very little or no VAT left to recover or likely to be incurred. Post deregistration, the company can recover input VAT.

Stamp taxes will be payable in the normal way. However, this will generally be a matter for the purchaser and the company being in administration should not impact this. For stamp taxes, normal service resumes.

### Conclusion

Tax is taxing and administrations make it more so. As post-appointment corporate tax is an expense of the administration, it may be worthwhile assessing any income and gains likely to arise in the administration period upfront, in order to consider what shelter is available to reduce or eliminate taxable income or opportunities to utilise tax attributes to generate tax refunds. Across the taxes, there are a number of complex issues relating to tax administration, tax groupings and the nature of income likely to be realised in the administration which may also need to to be assessed in order to confirm the tax treatment that may apply. Careful assessment may make a difference. □

[1] Broadly SDLT applies to UK real estate situated outside Scotland and certain partnerships which themselves hold said real estate. LBTT applies to real estate situated in Scotland and certain partnerships which themselves hold said real estate.

**SUWIN LEE (LEFT)** is a partner in transaction tax at EY.

**SCOTT BRADY (RIGHT)** is a director in transaction tax at EY.

# Avoiding disaster

**James Dowers** looks at how HMRC is trying to close the tax gap and the potential pitfalls of EBTs and tax avoidance connected to insolvency.

The increased popularity of tax avoidance schemes has been met by increased targeting by HM Revenue & Customs (HMRC) in an effort to bridge the tax gap.

Introduced on 17 July 2014, accelerated payment notices (APNs) are a requirement to make a payment on account for tax owed following the use of a tax avoidance scheme. The new legislation puts the burden of proof on the taxpayer and gives HMRC the power to demand payment of tax without waiting to settle open appeals. Upon receipt of an APN, the tax is due within 90 days. Failure to pay can lead to additional penalties and insolvency.

Also introduced in 2014, follower notices are sent to users of avoidance schemes where a court or tribunal had made a final ruling in favour of HMRC. A follower notice gives a scheme user a choice to either:

- settle their case and take the corrective action required; or
- litigate their case and face a penalty, if ultimately, they lose.

### Beneficial, but trustworthy?

Employee benefit trusts (EBTs) have been especially targeted via APNs. EBTs are generally set up to benefit a company director, but sometimes also benefit key employees. Monies are paid to trustees, usually offshore, who administer a fund on behalf of the trust's beneficiaries, the director or key employee. The monies paid to the trusts from company profits are then loaned to the beneficiaries, usually never to be repaid. As such the loans are not subject to income tax. In theory, the loans can at any time be recalled albeit they generally aren't and are often written off in their entirety.

Promoters of such schemes usually charge significant amounts to set up and administer a tax avoidance scheme. However, compared to the potential tax saving, clients rarely seem to have a problem with the set-up costs. Promoters would have likely used a scheme several times before selling the 'package' to various clients. As such the paperwork is often pre-drafted and packaged for ease of implementation – a general worry when you consider how much you are paying for a bundle of papers that often is left unread!

Each scheme usually receives generic advice from a tax barrister. The problem for companies entering tax schemes is that the legal advice provided isn't for the benefit of the company but for the scheme promoter, and is usually sufficiently 'woolly' that it gives almost a 50/50 divide of advice about the scheme's legitimacy given the purpose of the legislation.

> HMRC will likely be the largest creditor in most insolvency situations and they are looking for IPs to pursue the directors and beneficiaries of tax schemes.

### Retrospective legislation

Commentators have questioned whether it is fair or right that the government can retrospectively change the law to make a tax avoidance scheme illegal.

However, all client engagement letters from promoters warn and discuss the possibility of retrospective legislation being brought in to make a scheme illegal. The engagement letters also state that if the law is changed then the tax owed will become due and payable by the client.

### From an IP's perspective

HMRC are becoming increasingly aggressive when it comes to insolvent companies that have been involved in a tax avoidance scheme. Given the significant tax advantages to entering a tax scheme, HMRC will likely be the largest creditor in most insolvency situations and they are looking for IPs to pursue the directors and beneficiaries of tax schemes.

Directors are often well advised and rarely agree to simply repay the money on demand. From experience, letters before actions may lead to negotiations, but it is likely that a detailed witness statement, evidence and an issued application in court will be needed to bring the matter to a successful resolution. Obviously, this process can be both costly and lengthy.

### Claims and recoveries

When seeking to recover funds back into a liquidation estate following insolvency on the back of an APN or tax assessment for using a tax avoidance scheme, there are usually a number of potential claims that can be brought against the directors and beneficiaries.

Some of these claims will depend on when the action took place. Schemes will invariably have been used for many years and, as such, usual two-year insolvency time limits on claims might prevent these actions. The appropriate action will often depend upon the nature of the scheme and the facts of the case. Section 423 of the Insolvency Act 1986 (transactions defrauding creditors) is often used; given there is no time limit, IPs can deal with tax schemes that have been in existence over many years. Other potential issues for directors to consider in addition to claims against them by IPs for engaging in tax avoidance schemes include potential personal liability claims by HMRC in respect of the NIC elements of the tax savings.

The key task is to establish the purpose of the schemes – and it is often difficult for any director to argue that the purpose of the scheme was anything other than to reduce tax. Generally, in any tax scheme, monies will have been paid out of the company, with the company receiving little or no benefit. Engagement letters usually provide valuable evidence that the directors were fully aware that they were entering a scheme that might not remain legal and that they could be liable to repay the tax.

IPs should also be aware that HMRC is committing significant resources to this area, and where an IP is not performing investigations to the satisfaction of HMRC, they are liable to find themselves replaced!

**JAMES DOWERS** is a partner at CVR Global LLP.



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# Property – a Value Added Trap?

**Vaughn Chown** explains how VAT can get complicated with building sales.

Having worked in VAT for more years than I care to remember, and a lot of that time spent working with insolvency practitioners, one of the most frequently asked questions I hear seems fairly innocuous: 'Do I charge VAT on the sale of a building?'.

Upon discovering that the building is commercial and more than three years old (any sale of a building that is less than three years old is automatically standard rated each time it is sold by way of freehold sale), my next question is: 'Is there an option to tax exercised upon the building?'. Exercising the option to tax converts the sale of an otherwise exempt building into a taxable supply in most circumstances.

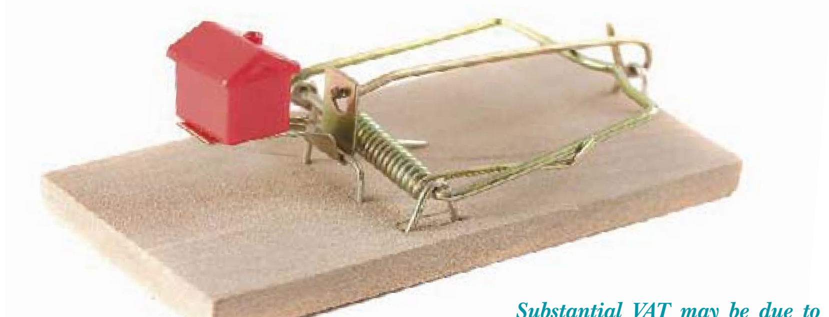
An option to tax is exercised on a building-by-building basis. The fact that a building is sold to a business and VAT was charged as the option to tax was exercised, does not mean that the option to tax is effective in the buyer's hands. The buyer must also opt to tax and notify HMRC if they wish the property to have an effective option to tax exercised. If the buyer does not opt to tax but uses the property to make taxable supplies and therefore claims the VAT on purchase and the building is subsequently sold, the sale will be exempt and, generally, the VAT incurred on the sale costs will be irrecoverable. However, that may be the least of the problems.

### A primer for practitioners

The sale of a commercial property that is more than three years old is exempt for VAT purposes under Schedule 9 to the VAT Act 1994. In addition, if the property was acquired by the purchaser within the last ten years, the property may be subject to Capital Goods Scheme (CGS) adjustments. This requires an adjustment to the original VAT reclaimed if the property was acquired for £250,000 or more plus VAT or any refurbishment of alteration works have been conducted costing £250,000 or more plus VAT, and an exempt supply in the property is made within ten years of its acquisition or improvement.

Here is what HMRC say in their notice 700/56 for insolvency practitioners (my comments are in ***colour***).

*'If the insolvent business had assets covered by the CGS (see VAT notice 706/2: Capital Goods Scheme) then those assets pass to the office-holder on insolvency. If the use of the assets changes while under the office-holder's control then adjustments may arise, which must be declared on returns due from the office-holder.'* ***This can pose real problems for practitioners who sell buildings on an exempt basis only to find the property is within the CGS and there is a clawback of VAT required post-appointment. A complete history of the building is required to determine whether there will be a clawback of VAT under the CGS and this is not always apparent at the time of acquisition.***



'The office-holder will need to establish the following information:

- what assets covered by the CGS are held
- when they came into use in the business
- how much input tax was initially incurred and deducted on them.'

***As indicated above the VAT incurred may have been upon acquisition, refurbishment or enlargement of the building.***

### 15.3.1 Assets still used within the business

*'Any adjustments are likely to be modest as they will only address the time of use by the office-holder and the difference between their use and that originally made by the business prior to insolvency.'* ***This needs to be reviewed extremely carefully given the long periods insolvency can take and the intentions of the practitioner with respect to the property and whether taxable supplies are envisaged for the future.***

*'If the office-holder brings the company out of insolvency or sells its assets as a transfer of a business as a going concern then any CGS items will pass on to the new owners at that point.'* ***The balance of any CGS adjustments will pass to the transferee. If the property has an option to tax exercised upon it, make sure the appropriate conditions are fulfilled by the purchaser to enable the property to be transferred as the transfer of a business as a going concern making the transaction outside the scope of VAT in the transferor's hands.***

### 15.3.2 Assets no longer used within the business but held for eventual sale

*'If the original use was taxable and the sale will be exempt then there may be substantial adjustments due. As the sale will be made by and under the direction of the office-holder adjustments must be declared by them on returns that they submit. If the asset is a building then it may be possible to prevent the sale from being exempt by opting to tax (see VAT notice 742A: opting to tax land and buildings), although this may restrict what buyers may be interested.'*

***Substantial VAT may be due to HMRC under the CGS post-appointment if a property is sold on an exempt basis. The option to tax and charging VAT will resolve the issue but commercial aspects should also be considered.***

*'If the original use of the assets was partly exempt, and if the sale is to be taxable, then adjustments in the office-holder's favour may arise.'* ***This is a point often missed and can result in significant sums being due from HMRC post-appointment.***

*'If the business is deregistered without a sale of the asset taking place then an adjustment may arise at that time.'* ***If ever there was a reason not to deregister from VAT! Cancellation of the VAT number can cause a deemed supply and required payment of VAT or a clawback of VAT if the option to tax has not been exercised.***

### Conclusion

The sale of commercial properties on an exempt basis can have considerable impact to VAT recoveries and may cause a clawback of VAT where properties are sold exempt from VAT and they are within the CGS.

The transfer of a property to the business pre-appointment may have been effected as the transfer of a business as a going concern (TOGC) and outside the scope of VAT. Although no VAT would have been claimed on acquisition, the outstanding CGS adjustments are passed to the purchaser and adjustments to the VAT originally claimed by the seller may be required post-appointment if the sale occurs on an exempt basis within ten years of the original VAT claimed. Getting this information from a business can be impossible, necessitating that the building is sold with an option to tax in place, charging VAT on the sale.

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# Is litigation funding what you think it is?

**Mark Beaumont** dispels the myths around funding insolvency litigation.

Litigation funding means different things to different people. It's a catch-all term that includes conditional fee agreements (CFAs), after-the-event (ATE) legal expenses insurance, damages-based agreements (DBAs), work in progress (WIP) funding, disbursement funding and of course non-recourse, third-party funding. In addition to these options,

"This means that there are options for virtually any claim arising from insolvency."

there are also funds that take assignment of claims for an upfront fee or a share of recoveries made, or a combination of the two. *This means that there are options for virtually any claim arising from insolvency.*

### Open options for funding

You have choices whether you are seeking to close an appointment and want to release value from a series of small claims (of just tens of thousands of pounds), or need funding to pursue large-scale, complicated actions across multiple jurisdictions. There are funding options for investigations, counsel opinions, forensic work and just about anything else. Cases can be funded from day one or just weeks before trial.

There are more than a dozen ATE insurers in the market, and well over 30 funding providers – including the eight members of the Association of Litigation Funders, a voluntary body with its own code of conduct.

With such a wide range of options, and such strong competition for cases from funders, there is bound to be an awful lot of price competition in the market. Despite this, I hear far too often that 'funders want 30 per cent'. *In my experience, the 30 per cent figure doesn't reflect the reality of the market.*

### What funders want

It is far more common for the funders' return to rise over time, reflecting their increased investment and the higher risk should a case run all the way to trial. As well as changing returns on the actual investment amount, funders will also usually have a share of damages.

When a funder is entitled to a percentage share of recoveries, the benefit to the client is that the funder's interests become aligned with those of the client: everyone wants as large a settlement or award as possible. If the funder's returns are instead a fixed multiple of their investment, they might be keen for a case to settle at a lower level than the client might like: because a low settlement might be enough to meet the funder's expected returns. *Structuring a funding deal at the outset to align all interests as best as possible is crucial.*

The percentage return to a funder does not have to be fixed. It can change over time and can also move in relation to the recovery made. For example, it may on occasion be preferable to have a funder take a larger share of a bigger settlement. This could be used to motivate your funder to play the 'long game' rather than be willing to accept a low offer made early in the process.

There are vastly different approaches taken to deal structures, and the impact on returns can accordingly be just as large.

"In my experience, the 30 per cent figure [for funders] doesn't reflect the reality of the market."

Despite this, many lawyers only submit cases to one or two funders rather than seeking the best possible deal. *I do wonder at times what this approach might mean for future professional negligence claims…*

### Making a decision

I find IPs are generally very open about their thinking when it comes to choosing law firms to instruct. It is no secret that reciprocal relationships are important, alongside many other factors. It will therefore come as no surprise that lawyers have similar considerations when choosing funders to work with. Does this approach

"Structuring a funding deal at the outset to align all interests as best as possible is crucial."

get the best deal for creditors? Does it ensure that the IP's fees are considered too, or is it just the lawyers that will be funded? Will it be the best deal for creditors? Is there any way of showing that the market has been tested, should creditors enquire?

It can also be helpful to have options to put to creditors. For example, a package could be put together that allows creditors to part-fund the claim to a fixed level. This would give creditors certainty over their investment, while also minimising the need for third-party funding. It may be much easier to access funds from creditors if at the same time you can show how the case can be funded through to conclusion without asking them for further funds in six months' time.

### Change and challenges

To summarise, the market for funding (in all its guises) is evolving rapidly and creating better and more affordable options for insolvency disputes of all descriptions. This creates opportunities to pursue cases that might have previously withered on the vine. But a wider range of options brings its own challenges, and insolvency litigators may not be best placed to navigate the funding market on your behalf.

To put it another way, do you instruct an insurance lawyer to broker your professional indemnity insurance renewal?

**MARK BEAUMONT** is co-founder of Annecto Legal Ltd, an FSA regulated, full market broker accessing litigation funding and ATE insurance for a wide range of insolvency related disputes.

# How complete is complete? Good question!

**Kathryn Maclennan** examines the judgment in *Green (Supervisor of the Voluntary Arrangement of James Patrick Wright* v. *Wright)* v. *Wright* [2017] EWCA Civ 111.

The decision in this case has been long awaited by insolvency practitioners (IPs) and debtors alike. Many IPs have been unable to issue certificates of completion while this decision was pending, leaving uncertainty and discord within the industry and for debtors, resulting in a significant number of complaints to the recognised professional bodies (RPBs). Now we have clarity from the Court of Appeal (CoA) and while this is welcome the industry will need to digest the impact of the decision in respect of both live and closed IVAs.

> There will be a significant number of cases that have been closed where trusts were created and survive post closure.

### The facts

Mr Wright entered into an IVA with his creditors in 2007. This was an all assets IVA and those assets were held on trust for the benefit of the creditors. Mr Wright complied with all his obligations under the IVA and received his certificate of completion in 2013. Some months later two PPI mis-selling claims were upheld resulting in a payment of £24,500. The critical question was who was the correct recipient for those funds – the debtor or the former supervisor?

The lower courts decided the funds were due to the debtor. In the absence of anything to the contrary the certificate of completion was conclusive and it brought an end to the IVA and any trust that was created by it.

### Court of Appeal

The CoA took a different view and decided the funds are due to the supervisor. The fundamental points within the decision are as follows:

- The IVA in this case created an express trust. In the absence of specific provision for that trust to terminate, it must continue.
- The certificate of completion brings to an end the debtors liability to creditors within the IVA. What it does not do is extinguish those debts. Those liabilities continue and creditors have a right to take whatever benefit is available from the trust.
- The CoA has drawn a parallel between a certificate of completion in an IVA and a certificate of discharge in bankruptcy. This is interesting given that section 281(1) of the Insolvency Act 1986 clearly sets out the purpose and effect of a certificate of discharge but there is no corresponding provision within the Act/rules applicable to IVAs. Rule 6.34 of the Insolvency Rules 1986 sets out the procedure for completion and is silent on any effect of a certificate of completion.
- The CoA was assisted by *N T Gallagher & Son Ltd* v. *Tomlinson* [2002] EWCA Civ 404 despite Judge Hodge QC, on first appeal, deriving little benefit from this authority. The CoA took the view that, despite the fact that *Gallagher* dealt with termination rather than due completion, the burden on the debtor was the same – namely to demonstrate to the court why a trust should come to an end where a contract does not provide for that outcome (or indeed any outcome in this case).

> The industry will need to digest the impact of the decision in respect of both live and closed IVAs.

### Where now?

This decision does not affect all IVAs but is limited to those that create a trust and do not provide for that trust to end on completion. This will be a sizeable number and there seem to be very few that would have made the necessary provision to end the trust.

IPs will undoubtedly be relieved that they can now issue certificates of completion knowing what the trust position is. However, the implications of this judgment go much further. There will be a significant number of cases that have been closed where trusts were created and survive post closure. In those cases the IP will be trustee of that ongoing trust and there will be concerns as to the obligations of the IP in that role. IPs could find themselves as trustees of trusts that they may never have anticipated or wanted, and there are real practical issues in terms of file retention, how long that trust will continue, what happens when an IP retires etc.

> IPs could find themselves as trustees of trusts that they may never have anticipated or wanted and there are real practical issues.

In addition there will be concern for debtors who have pursued PPI mis-selling claims, or are in the process of doing so, post completion (thinking that complete actually meant complete) and are now faced with the prospect of having no contractual right to those funds.

The banks also have to consider who the funds should be paid to, bearing in mind not just whether an individual is currently in an IVA, but whether they have ever been in one.

I first commented on this case for *RECOVERY* magazine in Autumn 2015. At that point the case had been before Burnley county court in October 2014 and had been heard on appeal in the High Court in Manchester in February 2015. The decision of both was that the funds in question should be paid to the debtor. The CoA has now overturned that. The answer to the question 'how complete is complete?' is now not so easy to answer.

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# Compensation orders: a quiet revolution

**Sarah Paterson** puts forward her opinion on the company directors' disqualification regime.

The Small Business, Enterprise and Employment Act 2015 made a number of significant changes to corporate insolvency law in England and Wales. Perhaps because it was a consolidated act (making changes to issues as diverse as insolvency law, the pubs code and nursery education), or perhaps because legislative provisions only really achieve impact when test-driven in the courts, some of these changes have not attracted as much attention as we might have expected.

This article focuses on the changes to the company directors' disqualification regime, and on only one specific aspect of the changes to that regime. But in doing so it seeks to show that the reforms suggest a real shift in public policy and legislative intent: nothing short of a quiet revolution. It is necessary to start with an overview of one particular aspect of how English corporate insolvency law has addressed duties to creditors since the Insolvency Act 1986.

### Are all creditors created equal?

Somewhat surprisingly, given the long evolutionary history of both the common law and the statutory duties of directors when a company is in financial distress, many aspects of both regimes remain highly uncertain in English law. Hence, there is vigorous debate in cases and literature about when a duty to creditors intervenes, the extent of that duty, the standard directors must attain and the right approach to compensation. One of the most vexing issues in this sea of uncertainty is how the interests of different creditors should be weighed against each other once a shift in emphasis from shareholders to creditors has occurred. Yet this is also one of the most significant policy questions for corporate insolvency law, and the way in which a jurisdiction answers it tells us a great deal about its overall policy approach.

A simple example will suffice: a retail store is in serious financial trouble in the period approaching Christmas. It continues to negotiate with its principal bank lender but it seems inevitable that it will either be placed into administration and its business and assets sold, or that it will be liquidated. The bank, the company's directors and both parties' financial advisers all agree that the Christmas period will be the most profitable trading period of the company's year. However, on almost any assessment, the bank's security is worth less than its secured debt and so, without any other intervention, any book debts that are gathered in are likely to be applied almost exclusively in favour of the bank once the company goes into insolvency proceedings. The bank is fully aware of the company's financial position, and makes its decisions from a position of knowledge. But the company has managed to maintain a 'business as usual' approach with many of its suppliers and the reality is that during the profitable trading period many suppliers' credit balances with the company will increase. What should the directors do? Should they forego the profitable trading period entirely, with an overall loss to the company, or take the benefit of the profitable trading period in favour of the bank and to the detriment of other creditors? A middle ground is technically possible in which a schedule of creditors is drawn up, and payments are made into a trust account during the trading period to compensate suppliers whose balances increase during the vulnerable period. But the costs and complexity of this exercise are likely to outweigh the benefit of the trading period for a company of this size. The payment to the bank will not be capable of challenge as a preference, as it will be made as a distribution in the ensuing insolvency proceedings.

> "The reforms suggest a real shift in public policy and legislative intent: nothing short of a quiet revolution."

### A more nuanced approach

In much of the EU, the policy answer clearly favours filing for an insolvency process (even if it results in an overall loss to the company) over taking the benefit of a profitable trading period, which prejudices some creditors. This manifests itself in the widespread implementation of a mandatory filing rule on insolvency (although the definition of insolvency, the time periods and the consequences for breach vary). England has traditionally taken a more nuanced approach. First, although there is still little colour around the test, it is tolerably clear that at common law, once the company is insolvent or somewhere close to it that, although the directors must have regard to the interests of creditors, their duty is still a duty to the company and not a direct duty to individual creditors. Furthermore, in considering the interests of creditors the directors must have regard to the interests

of creditors as a whole. Space and time do not permit a full evaluation of these contested ideas, but it does appear that, as the duty is to the company and not to individual creditors, directors can navigate the choppy waters of a breach of duty claim if they have traded the company for a profitable period.

Secondly, recent case law suggests a similar approach in wrongful trading legislation. As English insolvency law has no mandatory insolvency filing rule, the wrongful trading provisions in section 214 of the Insolvency Act 1986 seek to ensure that directors will not blindly trade on when further losses to creditors seem inevitable. The way in which English wrongful trading legislation responds to the 'profitable for some' trading dilemma is instructive. In the recent case of *Ralls Builders*, Snowden J considered that legislative intent (or at least legislative drafting) was firmly on the side of profitable trading.[1] In that case he considered that at a certain point in time the directors had reached the point where they should have known that there was no reasonable prospect of avoiding insolvent liquidation (and so were wrongfully trading), and that they could not take the benefit of the defence to wrongful trading because continued trading had increased the losses of some creditors. However, no contribution order was made because the measure for contribution was the company's loss (not the losses of individual creditors) and the company had traded at a profit, albeit, as in our example, for the benefit of the bank but to the detriment of other creditors.

> "One of the most vexing issues in this sea of uncertainty is how the interests of different creditors should be weighed against each other once a shift in emphasis from shareholders to creditors has occurred."

## Parliamentary intent

Finally, even in the more controversial case where the company has traded in a way certain to prejudice an individual creditor, the courts have discerned a clear Parliamentary intent to focus on loss to the company. In *Morphitis* v. *Bernasconi* the court was faced with a situation in which the corporate insolvency had been structured around avoiding the effects of section 216 of the Insolvency Act 1986 and certain of the voidable transaction rules, in full directorial knowledge that a promised payment, which a single creditor expected to receive, would never be made.[2] The court focused on the fact that, when comparing the fraudulent trading provisions in section 213 of the Insolvency Act 1986 with its predecessor in section 332 of the Companies Act 1948, that

*'an application … cannot be made by an individual creditor; it can only be made by a liquidator. And the order which the court can now make under section 213 is for contribution to the company's assets.'*

In considering situations in which compensation would be appropriate, the court gave the examples of a misappropriation of company assets, or a claim against the company that must be reimbursed, rather than a loss to an individual creditor, which did not deplete the company's assets.

Thus, English law appears to favour the benefits of profitable trading for the whole against possible detriment for the minority. It is against this background that the recent amendments to the company directors' disqualification regime have considerable significance, because indisputably the legislative intention is to enable compensation to be directed in favour of an individual creditor or creditors, rather than the company in appropriate cases. Thus the claim is made that the new provisions represent something of a quiet revolution; but like most revolutions the results are rather messy.

## History of the revolution

Disqualification was first introduced into English law by the Companies Act 1929, which provided for the automatic disqualification of undischarged bankrupts and for disqualification at the discretion of the court for an individual found to be in breach of the fraudulent trading provisions of the time. Amendments were made in 1947 and 1976, but the most radical change was the introduction of the Company Directors Disqualification Act 1986 (CDDA). While this retained discretionary disqualification for participation in fraudulent and newly introduced wrongful trading (section 10), and mandatory disqualification for undischarged bankrupts (section 11), it also introduced much broader grounds of mandatory disqualification for unfitness in section 6. Nonetheless, the focus of the regime was still on taking errant directors » off the corporate road (and deterring others from following in their path), so that there was not much to interest the insolvency practitioner seeking a return for unsecured creditors. Matters rested in this way until the introduction of the Small Business, Enterprise and Employment Act 2015 (SBEEA).

The SBEEA brings the power to seek compensation for creditors within state remedies for the first time. Section 110 of the SBEEA inserts new provisions into the CDDA empowering the Secretary of State to apply to court for a compensatory award to be made against a director who has been disqualified where actions have caused loss 'to one or more creditors'. In case there can be any doubt about Parliamentary intention, the amendments make clear that compensation may be paid *for the benefit of a creditor or creditors specified in the order, a class or classes of creditor or creditors so specified* (my emphasis) or as a contribution to the assets of the company. Moreover, the undertakings regime is extended to include compensation undertakings that

> **English law appears to favour the benefits of profitable trading for the whole against possible detriment for the minority.**

may also provide for payment to a specified creditor or creditors or class as an alternative to a contribution to the assets of the company. Thus the quiet revolution: against a legislative and common law architecture that focuses on loss to the company, we are faced with explicit statutory remedies that can be directed towards a particular creditor or creditors. Suddenly there is much to interest the insolvency practitioner in the remedies available to the state.

### Compensation and disqualification

Of course, the compensation regime remains linked to disqualification, so that it will only be available where the directors have been disqualified by the court or have entered into a disqualification undertaking. The directors in *Ralls Builders* would not be vulnerable to disqualification based on participation in wrongful trading because section 10 of the CDDA 1986 requires that the court has made a declaration that the director is liable to make a contribution to the company's assets. Thus, might a liquidator in our retail store case be better advised not to pursue wrongful trading but to try to encourage the Insolvency Service to pursue disqualification on the broader ground of unfitness, with a view to engaging compensation in favour of unsecured creditors? Notwithstanding comments from Vicky Bagnall of the Insolvency Service in the Winter 2016 edition of *RECOVERY* that, 'The Insolvency Service does not intend to usurp the asset recovery role of IPs', going forward a liquidator would be well-advised to make the compensation element of disqualification an explicit consideration and, in appropriate cases, to defer to the Insolvency Service in order to engage the special aspects of the new regime.

This will also require an assessment of the prospects of the Insolvency Service being prepared to pursue the disqualification and the prospects of obtaining it. To date the courts have been extremely reluctant to disqualify for anything falling short of dishonesty, so the question arises as to whether the SBEEA amendments mandate a new approach. While there is nothing in the amendments explicitly requiring a new approach, section 106 of the SBEEA incorporates a new Schedule 1 into the CDDA, requiring the court to have regard to the 'nature and extent of any loss or harm caused, or any potential loss or harm which could have been caused, by the person's conduct in relation to a company or overseas company' (paragraph 4 of the new Schedule 1). Notwithstanding concerns from the Institute of Directors during consultation that, considering wider social impacts in disqualification proceedings, implicated an imprecise and political concept – and concerns from the Corporate Governance Network that it introduced an 'undesirable layer of subjectivity' – this provision appears explicitly designed to enable the court to think about the type of loss that has been incurred, and to whom. One cannot help but think of recent cases in which particularly vulnerable creditors, or creditors with weak market bargaining power, have suffered loss, but efforts by the state to hold the directors to account have failed. In our example, is paragraph 4 wide enough to cover small suppliers prejudiced in favour of a powerful bank? Or does it matter how many suppliers there are? Or what their other prospects in the region are? We must also remember that most disqualifications are implemented via the undertakings route.

### A politically engaged revolution

The fear, of course, is that as the consultation responses suggest this may become a somewhat politically engaged remedy. One can imagine advice to directors being tested against a 'newspaper test': if the potential losses to individual creditors are of a type likely to be intolerable to public opinion, then profitable trading potential ought best be eschewed, but if the potential losses are to individual creditors who might be politically expendable beneath the wheels of the proverbial bus, then the profitable trading opportunity can be grasped. There is little (at least until some case law is established) that can safely be used as a principled guide for directors.

In any liberal democracy law is administered impersonally precisely so that it is applied consistently and regardless of the particular interests of those administering it. Thus, disqualification accompanied by *directed* compensation at the hands of the Secretary of State feels uncomfortable, particularly when the rest of our civil liability regime rests on loss to the company. Once again,

> **A liquidator would be well-advised to make the compensation element of disqualification an explicit consideration.**

English corporate insolvency law appears to have developed in a somewhat *ad hoc* and responsive fashion. In the *Robin Hood Centre* case the court agreed with Snowden J that there must be a net deficiency in the company's assets before a compensation order can be made.[3] If that case is the subject of an appeal, the Court of Appeal may yet go its own way. But if it is not or if, like Snowden J, the Court of Appeal were to determine that any reform is a matter for Parliament, then notwithstanding the pressures on legislative time this is a matter which Parliament should take up. At the moment the revolution seems to have left us in something of an incoherent state.

*I am grateful to Professor Peter Walton for comments on an earlier draft. All views expressed are my own, and I am responsible for any errors or omissions.*

1. *Re Ralls Builders Ltd (in liquidation) Grant and another* v. *Ralls and others* [2016] EWHC 243 (Ch)
2. *Morphitis* v. *Bernasconi* [2003] EWCA Civ 289 at [47]
3. *Brooks* v. *Armstrong* [2016] EWHC 2893 (Ch)

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# Unbending the Insolvency Rules 2016 – part 2

**Christina Fitzgerald**, **Tania Clench** and **Andrew Brown** provide a review of deemed consent and CVL procedure.

In the spring edition we looked at one of the primary changes to the decision-making procedure introduced by the new Insolvency Rules 2016. Unsurprisingly, the nature of these changes has created a certain amount of confusion among practitioners. The two chief examples are:

1) the application of the amended 'single 10 rule' in the deemed consent procedure as opposed to the 'triple 10 rule' for requesting physical meetings, and
2) the use of the deemed consent procedure within the CVL context.

Much like a traveller trying to navigate through modern Greece using only a well-worn copy of Pausanius' *Description of Greece*, an office-holder trying to understand the various decision-making procedures is likely to be in need of a updated map to guide him through the various twists and turns of the legislation.

> "Much like a traveller trying to navigate through modern Greece using only a well-worn copy of Pausanius' *Description of Greece*, an office-holder trying to understand the various decision-making procedures is likely to be in need of a updated map."

To that end we have produced three flowcharts to assist in understanding the course an office-holder should chart, and we have included below some practical advice to avoid some of the stranger tides of insolvency decision-making procedures.

### Single 10 in deemed consent procedure (diagram 1)

There has been some confusion among practitioners regarding which 'rules of 10s' threshold must be applied in the deemed consent procedure. We sought to clarify this in our previous article, but some confusion remains due to conflicting » information given by some speakers and secondary literature. To assist office-holders in understanding the deemed consent procedure we offer the example of diagram 1 as a flowchart of decisions to be taken, and further offer the below commentary to clarify the issues.

The 2016 rules do not explicitly state the applicable threshold of objection for the deemed consent procedure and instead directs office-holders to consult s246ZF of the Insolvency Act 1986.

Rule 15.7(3) refers to objections from the 'appropriate number of relevant creditors.' S246ZF(6) IA 1986 defines 'the appropriate number' as **10 per cent in value** of the creditors or contributories. It must be stressed that this is **10 per cent in value**, and not '10 in number' or '10 per cent in number of the creditors' as found in the qualifying decision-making procedure. These three different thresholds have been mixed-up by some commentators, which has caused some

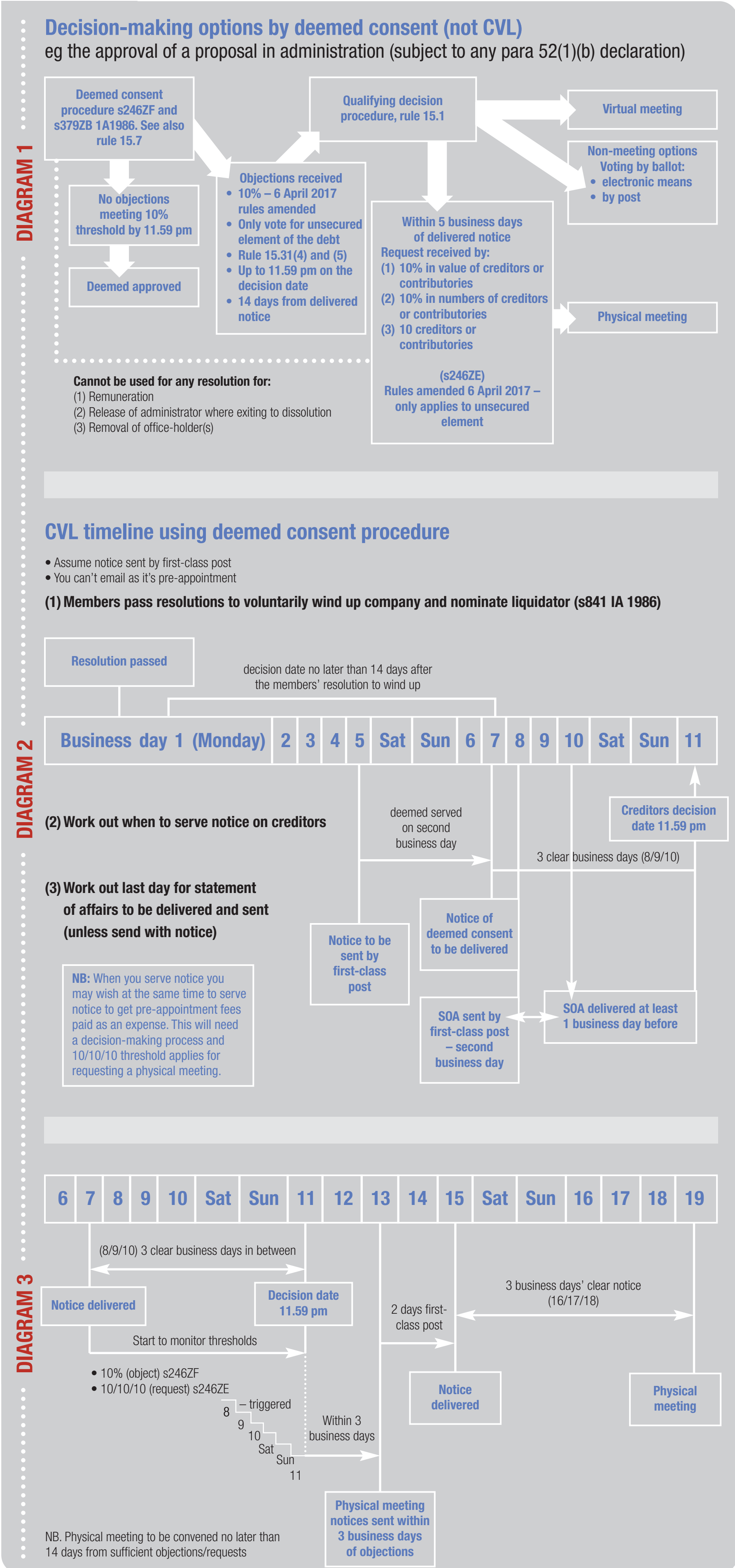
> Office-holders should take note of the *10 per cent in value* threshold as being the 'single 10 rule' for objections in the deemed consent procedure.

confusion and disarray. For example, at the time of writing, in the 2017 edition of *Sealy & Milman: Annotated Guide to the Insolvency Legislation*, the general note to ss246ZE–246ZG erroneously states the threshold as being 'generally 10 per cent or 10 in number'. This ambiguous and incorrect statement should be disregarded, and office-holders should take note of the **10 per cent in value** threshold as being the 'single 10 rule' for objections in the deemed consent procedure.

Under the 'single 10 rule' it is important to understand how the 'value of creditors' is calculated, which can be found in rule 15.31. It is important to note that under 15.31(4) secured creditors have no voting rights, and under 15.31(5) partially secured creditors only have voting rights equivalent to the value of their unsecured debt.

The deadline for objections under the deemed consent procedure is 11.59 pm on the decision date. Guidance on the minimum number of days of notice between delivery of the notice of deemed consent procedure and the deadline for objections can be found in rule 15.11.

Regarding 'notices of the deemed consent procedure' we query whether it is



necessary to send a standardised 'notice of objection' form for creditors to fill in and return. Rule 15.7(2)(a) requires no such prepared blank notice, and the possibility exists that a prepared form might encourage creditors to object where they otherwise would not. We encourage office-holders to use first-class post for delivery of any notes of the deemed consent procedure (or under the qualifying decision-making procedure) as this will ensure consistency in time calculations for deadlines.

### Triple 10 in deemed consent procedure

One final point to consider is when the 'triple 10 rule' will apply to the deemed consent procedure. As noted above, the 'single 10 rule' of **10 per cent in value** is the only applicable rule for objections in the deemed consent procedure, but creditors can still demand a physical meeting. Under s246ZE(3) IA 1986, if the 'minimum number of creditors' request a physical meeting it must be held. The 'minimum number' is defined at s246(7) IA 1986 as: 10 per cent in value of creditors; 10 per cent in number of creditors; or 10 creditors. It is important to note that this is specifically for notices to request a physical meeting. If 10 creditors merely object to a deemed consent procedure, but do not constitute 10 per cent of the value of creditors, then consent will be deemed to exist, and no physical meeting will be called as the 10 creditors merely objected and didn't request a physical meeting. Notices demanding a physical meeting must be received within five business days of delivery of the notice of deemed consent procedure.

> Until IT systems for virtual meetings are proven reliable, we advise the use of the deemed consent procedure and service of any notices by first-class post.

### The deemed consent procedure in the context of a CVL (diagrams 2 & 3)

The deemed consent procedure has further application under rule 6.14 for the nomination of a liquidator by company directors entering into a CVL. Rule 6.14(2) allows company directors to seek a decision of the creditors regarding the nomination of a liquidator by either:
1) the deemed consent procedure, or
2) a virtual meeting.

Until IT systems for virtual meetings are proven reliable, we advise the use of the deemed consent procedure and service of any notices by first-class post. To assist office-holders we have prepared two further flowcharts opposite to assist in understanding the procedure for deemed consent under rule 6.14.

### Hybrid 10s

As with the standard deemed consent procedure (discussed above), company directors must monitor both the single 10 rule and the triple 10 rule. Under 6.14(3) directors must send notices to creditors for the nomination of a liquidator and state a decision date not earlier than three business days after deemed delivery of the notice (deemed service is always two business days from posting), and no more than 14 total days after the resolution to wind-up the company. If before 11.59 pm on the decision date **10 per cent in value** (the single 10 rule) of the creditors object to the nomination of the liquidator, then the company directors *must* call a physical meeting under rule 15.6 for determination of the issue. The directors must send out notices under 15.6(3) convening a physical meeting. The physical meeting must not be heard earlier than three business days after deemed service of a notice under rule 15.6, and not more than 14 total days after the single 10 rule is triggered. This is a sort of hybridisation of the single 10 rule and the effect of the triple 10 rule.

The triple 10 rule also applies to rule 6.14 under subsection (6). However, unlike the normal triple 10 rule, which only allows requests for a physical meeting to be filed within five days of deemed service of any notice, rule 6.14(6)(a) notes that the triple 10 rule can be achieved at any point between deemed service and the decision date. So, for instance, if the company directors set a decision date at seven business days after deemed service of the notice, the triple 10 rule could be triggered at any point up to that decision date. In practice we expect most directors to set a decision date at three business days, so this peculiarity is unlikely to arise often.

### Practical points under rule 6.14

On a practical level, we would advise office-holders to meet with directors early to focus on completing the statement of affairs as soon as practicable, and to deliver the statement of affairs well in advance of the decision date rather than effecting delivery one business day before the decision date, this being the last possible date under rule 6.14(7).

> On a practical level, we would advise office-holders to meet with directors early to focus on completing the statement of affairs as soon as practicable, and to deliver the statement of affairs well in advance of the decision date.

Finally, under rule 6.19 the company directors must, at the same time as sending a notice under rule 6.14, also send notice to creditors inviting them to decide whether they wish to form a creditors' liquidation committee, and further to solicit any nominations for the committee. Under rule 17.2 such a committee is to assist the office-holder in the discharge of their duties.

### Conclusion

Despite the noble intentions behind the new rules to simplify insolvency procedures, the interplay of the deemed consent procedure with the qualifying decision-making procedure can be confusing. The variety of 'rules of 10s', the various deadlines and the required information to be included in notices can complicate what otherwise was meant to be a streamlined procedure. We hope the flowcharts accompanying this article are of assistance to the reader and reduce some of the confusion surrounding the rule changes. □

**CHRISTINA FITZGERALD (LEFT)** is a partner at Shakespeare Martineau.

**TANIA CLENCH (MIDDLE)** is legal director at Shakespeare Martineau.

**ANDREW BROWN (RIGHT)** is a barrister at Radcliffe Chambers.

# The big picture: R3's Annual Conference

R3's Annual Conference was held on 26–28 April 2017 at the Clayton Hotel, Burlington Road, Dublin.

BBC business editor Simon Jack brings delegates up-to-date on the wider business and economic landscape – including news that major banks see the UK insolvency and restructuring landscape as one of the best in the world.

INSOL vice-president Julie Hertzberg flew in from the US to update members on INSOL's objectives and work.

New R3 president Adrian Hyde sets out his plans for 2017–18: a focus on fraud, battling for the insolvency and restructuring profession, and promoting the profession's flexible skills set.

(left to right) Mark Sands (RSM & R3 Personal Insolvency Committee chair), Ruth Duncan (RNF Business Advisory), Joanna Elson OBE (Money Advice Trust) and Chief Registrar Stephen Baister discuss the current personal insolvency landscape, recent reforms, and potential future changes, including the possible introduction of a 'breathing space' from creditor action for those in debt.

Helena Walsh (Cicero Group) discusses the Brexit process with Simon Jack, Willie Day (Arthur Cox), Colm McCarthy (University College Dublin). The panel talked about its likely impact on the UK's insolvency and restructuring landscape, and how EU members may seek to take advantage from the UK's departure.

Opportunities and challenges for the profession in adapting to the government's proposed corporate insolvency reforms were debated by (left to right) Andrew Tate (Kreston Reeves & past R3 president), David Chubb (PwC), Howard Morris (Morrison & Foerster), and Duncan Parkes (IfT).

Detective sergeant Phil Ariss from East Midlands Police Operations Unit provides insights into the world of cryptocurrencies and bitcoin.



Editor recovery@r3.org.uk

R3 vice-president Stuart Frith opens and chairs the second day.

(left to right) Andrew Tate (Kreston Reeves & R3 past president), Regional Employment Judge Stuart Robertson (Employment Tribunals Service, England & Wales) and Elisa Charlton (Deloitte) discuss the interaction between insolvency and employment law and how insolvency practitioners should approach the employment tribunal process.

Tom Paton (Irwin Mitchell) updated members on the insolvency legal landscape.


Andrew Macmillan (Gateley) took delegates through practical ways to engage with the employment tribunals. Local versions of this session are taking place around the UK over the rest of 2017 – find out more on R3's website.

Hundreds of delegates from across the insolvency, restructuring, advisory, and turnaround profession gather for a chance to meet old and new colleagues and contacts.

Thanks to the sponsors of the R3 Annual Conference:

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# R3's Northern Conference

R3's Northern Conference was held on Friday, 24 March 2017 at the Ramside Hall Hotel, Durham.

Holding R3's Northern Conference in the North East for the first time was a smart decision. The region obliged with stunning sunshine and a comfortable and well-appointed venue – the Ramside Hall Hotel just outside Durham. With over 100 insolvency and restructuring professionals in attendance, the conference offered updates to delegates on vital areas of legal and professional practice, as well as sessions on structural changes to the UK business arena and the economy as a whole, which will inevitably affect the profession in years to come – and which are already having an impact.

Neil Harrold, chair of R3 North East and a partner at Hay & Kilner Law Firm, opened the conference with a speech highlighting the work that R3 does with and on behalf of the profession – to intercede with government proposals where necessary, to speak up for the profession in the media and to external organisations, and to give the profession opportunities to come together to learn, debate and plan for the future.

## Legal updates

Robert Brown of hlw Keeble Hawson LLP started off the conference's technical track with a comprehensive discussion of the administration of insolvent estates of deceased persons – a weighty topic to accompany the first coffee of the day, perhaps, but a necessary and well-delivered update.

An overview of recent legal decisions with potential implications for insolvency cases was ably given by Jonathan Rodger, a barrister at Enterprise Chambers, with notable recent developments such as *Green* v. *Wright* (see page 31) and *Re Shlosberg* considered, among others. Jonathan concluded by describing three trends in insolvency litigation that he believes are harmful to an IP's chances of favourable judgments:

- There is often a lack of complete information in the hands of a trustee, but trustees 'almost never' use their powers of examination regularly enough.
- The issuing of proceedings at the last possible moment harms chances of success, as deadlines such as the three-year claim on the matrimonial home can be missed.
- 'Overlitigation' in correspondence (the sending of 'endless letters' that 'argue [an issue] to death') is counterproductive.

Overlitigation was a *bête noire* for Patrick Walker of mediation firm imediate, who described his journey from 'red-blooded litigator' to mediator (and said that if he could manage the change in mindset, anyone could). He listed the 'C-features' of mediation – namely, that it is confidential, offers costs protection, is controlled, allows for creativity, and is cost-effective. Mediation, he emphasised, isn't about avoiding conflict, but rather about confronting it head-on and resolving it to the benefit of both parties.

On the topic of developments within insolvency, the introduction of the new rules [see pages 35–37] is the most significant change to hit the profession for many years. Caroline Sumner, R3's technical director, gave a polished and jargon-free update on the new rules, advising the audience to 'learn to love them – all 446 pages of them!' (You can read Caroline's initial breakdown on the rules in the Spring 2017 issue of *RECOVERY*).

## The future landscape

The talk by Graham Moore, head of business development at Atom Bank discussed how challenger banks and online money management platforms are already starting to prove to be competitors to established banks. He asked: 'Do you want a relationship with your bank or with your money?'. While high-profile scandals have eroded trust in high-street banks, new advances in communications have dramatically cut the costs associated with managing money. However, many traditional banks are still tied to expensive bricks-and-mortar premises, with elaborate systems set up to 'move bits of paper around'. Graham posited that traditional banks, which focus on excellent customer service, are perhaps better placed to survive and thrive, while challenger banks, with their lower costs and convenience for consumers, are also set to prosper; it is those in between, offering neither lower costs nor exemplary customer service, which he predicted will falter.

Mauricio Armellini, the Bank of England's agent in the North East, also looked to the future, with a lively and engaging update on the economic forecasts for the region, and for the UK as a whole. He said that markets are expecting interest rates to go up very slowly, to 0.75 per cent by around 2020 – 'still low by historical levels, but three times where they are currently,' he said. Consumption 'kept on going like a train' post-EU referendum, he pointed out, in contrast to general business sector pessimism about Brexit; whether this can be sustained is another question.

The weighty topic of 'The corporate insolvency framework and the future of restructuring' was taken on by a panel composed of Graham Dawson, Lloyds Bank; Martin Jesper, Rootcorz Limited; Josie Richardson, Rcapital; Nick Howard, Insolvency Service Policy Unit and Kevin Dolan, Pension Protection Fund, and chaired by Neil Harrold. Nick spoke of the Insolvency Service's aspiration to improve the UK's ranking in the World Bank's insolvency framework ratings, although a recent fall in our position had more to do with other countries improving their performance, rather than anything the UK has done. Graham Dawson noted that numbers of bank customers in financial distress had 'significantly reduced' over the years, and that a large majority of customers survive, thanks in part to measures like bringing in expert advice at an earlier stage and an increased use of informal procedures. As company accountants are often the first to spot signs of distress, how to reach out to them as a group in order to inform them about the skills and expertise of the insolvency and restructuring profession emerged as a key point.

In all, the day offered delegates a wide variety of talks on many subjects pertinent to the profession, along with a welcome opportunity to network and catch up with their contacts and old friends.

Thanks to the sponsors of the R3 Northern Conference:

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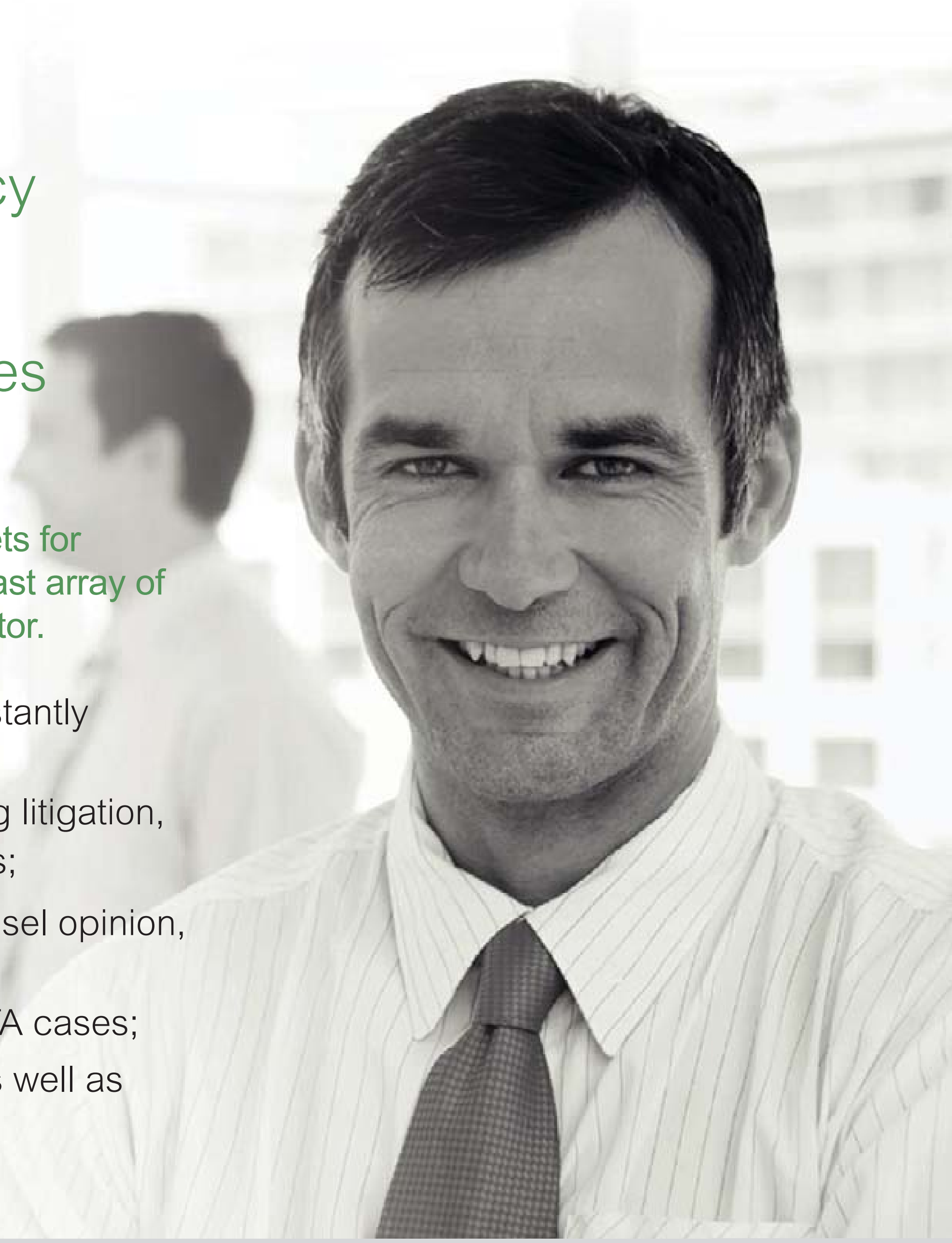
**JO TACON** is communications officer at R3.



Save the date
Southern Conference
**21–22 September**
Bournemouth

# R3 events, courses and conferences

| Month | Date | Event | Venue |
|---|---|---|---|
| June | 12 | North West Regional Meeting and BBQ | Manchester |
| | 13 | East Midlands New Professionals Quiz Night | Nottingham |
| | 14 | Scotland Golf Day | Berwick |
| | 16 | North West Women's Group Ladies Lunch | Manchester |
| | 21 | Southern Regional Meeting | Southampton |
| | 21 | Employment Tribunals (breakfast briefing) | Manchester |
| | 22 | London and South East: a Night on Brighton Pier | Brighton |
| | 23 | Yorkshire Regional Golf Day | Harrogate |
| | 28 | Employment Tribunals (breakfast briefing) | Birmingham |
| | 28 | North East Regional Meeting | Newcastle |
| | 29 | South West and Wales Regional Black Tie Dinner | Bristol |
| July | 4 | SPG Technical Review | Leeds |
| | 5 | Restructuring Day | London |
| | 6 | Yorkshire Regional BBQ | Leeds |
| | 13 | London and South East Region Summer BBQ | London |
| August | 17 | Scotland SWG Event | |
| | 31 | Scotland Breakfast Seminar | Glasgow |
| September | 5 | Practical Introduction to Insolvency Work – Personal Insolvency | London |
| | 12 | International Insolvency (breakfast briefing) | Birmingham |
| | 12 | London & South East Quiz Night | London |
| | 14 | Restructuring Solicitors' Firms (half day – am) | London |
| | 14 | CVAs (half day – pm) | London |
| | 19 | Pensions (breakfast briefing) | London |
| | 20 | Practical Introduction to Insolvency Work – Rescue, including administrations and CVAs | London |
| | 21–22 | Southern Conference | Bournemouth |
| | 25 | Joint R3 and ICAEW Eastern Regional Meeting | Bury St Edmunds |
| | 26 | London Regional Meeting | London |

Regional events
R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the 2017 Summer–Autumn programme. Alternatively, call the Courses team on 020 7566 4234 to request further details.

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# The fees regime so far: the smaller firm perspective

**Chris Herron** puts forward his opinion on the fees regime's effect on smaller firms' business practices.

Let's be honest, most people feel underpaid and insolvency practitioners are no different. Hence, the introduction of fee estimates seemed like unnecessary red tape at a time when we felt like we weren't getting a fair whack anyway. However, as with the new rules, we are where we are and we've had to embrace the process. Below are a series of observations on some of the issues that have arisen in the last 18 months.

## Background

Changes to fees were introduced by The Insolvency (Amendment) Rules 2015 in October of that year. Three bases of remuneration were now permitted: time, percentage or fixed fee. If going for time, IPs now have to produce an estimate up front before seeking approval from creditors.

> We are now in tick box land, driven to put lots of time down to different categories without necessarily assessing the time-consuming issues in a case.

R3 produced a guidance note in May 2016, which followed on from the revised SIP 9 issued in December 2015. This note is nine pages long and detailed; rather than consult it in every case, most IPs will almost certainly use a template. For the average SPG member templates will not have been produced in-house, but more likely by an external compliance provider.

Templates, however, do not necessarily encourage a proper thought process. In the past, we were always happy to give a narrative of why our fees might be significant and why we should be paid them. Having been forced down the road of a prescriptive estimate, we are now in tick box land, driven to put lots of time down to different categories without necessarily assessing the time-consuming issues in a case. We have to be careful, therefore, to produce something accurate.

How did we end up here? It's a matter of perspectives: the creditors and ours. They still think, often, that we are simply a cost, stripping all the available funds from the insolvent entity. Whereas we know we are fulfilling a vital role and, while we are not shy of work, we will not run up charges unnecessarily just to fill our own coffers.

In most cases, time costs are fairer than percentages, which treat cash at bank as being as difficult to realise as a disputed debtor. It's also worth mentioning that only one per cent of complaints to the Gateway in 2015 were about remuneration. Nonetheless, clearly the powers that be didn't like time costs.

It's worth remembering that the fee estimate regime is a compromise – the government originally wanted to abolish time costs altogether!

## Positives and negatives

A fee estimate concentrates the mind. Having done one for a case, perhaps we may be even more careful than before about the time we are spending and the money we might be recovering or wasting.

It's not so easy to get an estimate approved, however. My firm typically writes off £12,000–£15,000 on a straightforward liquidation, but putting the daunting real figure in the estimate annoys creditors, who think the IPs really get it – they don't read the statement of affairs.

On top of that, what's in it for the creditors? Why should they sign a fee resolution that gives us money but gives them less, or even nothing? Why would they engage and sign a fee resolution?

When they don't, we're left with calling a physical meeting (although not any more under the new rules) or an expensive application to court that any judge is going to find pretty trivial.

That's without even mentioning the problems when estimating disbursements. For example, chattel agents are really not on board with the fees regime and often can't (or won't) give us estimates.

## The SPG angle

So here's the rub. There is a real lack of understanding about how much we write off. In fact, we do a lot of jobs for nothing, as we only get the statement of affairs fee.

We could just reduce our charge-out rates and appear cheaper. But that's fatal for the one job in twenty where we make a half-decent recovery. It's a strange business model.

In an attempt to educate, we now add the *effective* (ie recoverable) charge-out rate (often nil) to our progress reports, to compare with theoretical rates. But that's after the event and does anyone read it?

Perhaps in a larger firm you could set up a department to do fee estimates and charge for it, but we just have to swallow it; it adds to the time we have to write off. That's not to say it's all beer and skittles in the big firms of course and we are part of SPG for a reason.

> In most cases, time costs are fairer than percentages, which treat cash at bank as being as difficult to realise as a disputed debtor.

## Other options

Should we ignore the inherent unfairness and only go for percentages or a fixed fee? We would still, it seems, have to justify why this is appropriate. Some SPG members have adopted a fixed fee just for statutory work, which generally wipes out every penny in the job, but they presumably still have to produce an estimate for the other work they do.

If we could force a change in policy, it might be better not to have an estimate – just specify a cap perhaps. Then we could go back to creditors if the cap was exceeded, as we have to anyway with an estimate. There's very little chance of this though, I suspect.

**CHRIS HERRON** is a co-founder and partner at Herron Fisher LLP.

# The role of R3's Fraud Group in the fight against fraud

**Frances Coulson** explains how R3's Fraud Group works with policymakers and government departments to affect real change.

The cost of fraud to the UK economy is never far from the headlines, nor should it be. It causes misery and unfair competition, and the available law enforcement resource to tackle it will never be enough. The insolvency profession has a key role to play in helping to tackle this huge economic and social problem. R3's Fraud Group works with public and private sector organisations, government, Parliament and the press to raise awareness of the powers insolvency practitioners have to tackle fraud – ensuring that insolvency is added to the anti-fraud and victim redress toolkit.

An overview of the Fraud Group's areas of work is outlined below. We are also looking forward to working closely with new R3 president Adrian Hyde (who specialises in fraud cases) to identify what further steps can be taken to help insolvency professionals tackle fraud and protect businesses, individuals and the wider economy.

### R3's fraud proposals

The Group's *'Fraud Landscape'* paper outlines a number of recommendations to provide the much needed extra capacity to combat fraud through the work of insolvency professionals.

Among the paper's proposals is a call to re-introduce criminal bankruptcy, allowing all of an individual's assets to be realised to repay victims following certain levels of criminal conviction, and making overseas assets easier to retrieve.

The report was launched at an event with stakeholders from the Federation of Small Businesses, Fraud Advisory Panel, Financial Conduct Authority, HMRC and the Home Office. The paper's recommendations form the basis of our continued engagement with key stakeholders.

### ECPG Insolvency Pilot

A significant amount of the Group's work is focused on the Insolvency Pilot of the Economic Crime Prevention Group, set up under the former National Fraud Agency in 2013. While we are currently unable to discuss many of the details due to confidentiality requirements, the pilot is an important part of our work – encouraging a range of government agencies and private sector organisations to use IPs' powers in fraud cases. The insolvency professions' wide-ranging powers offer these agencies an attractive alternative method for investigating fraud cases that they might not otherwise be able to resource. Many thousands of hours have been devoted by the Group to educating agencies and promoting the work of IPs.

### Engaging with key stakeholders

Recently, we met with the Home Office to discuss the role of insolvency in tackling fraud and received a very constructive response to the points raised. We hope to announce the positive outcomes from this meeting in the coming weeks.

> "The insolvency professions' wide-ranging powers offer these agencies an attractive alternative method for investigating fraud cases that they might not otherwise be able to resource."

Another key government department in respect of fraud issues is HMRC. R3 has had very productive engagement with HMRC over recent months, including a meeting with HMRC permanent secretary, Edward Troup, to discuss fraud and other issues. Troup welcomed the work of the profession and agreed to make sure more was done to improve interaction between HMRC and the insolvency profession. As chair of R3's Fraud Group, I subsequently met HMRC officials to discuss a number of key fraud issues affecting the profession. It was a very positive meeting with a number of outcomes we expect to hear about from HMRC soon.

We also met late last year with Tim Moss, CEO of Companies House, to discuss a wide range of fraud issues, including R3's concerns around the 'leaked report' on the Companies House proposals to delete the records of closed businesses after only six years. Tim confirmed that Companies House are keen to maintain a dialogue with R3 and we look forward to working with them over the coming months.

We hope the outcomes from these meetings will help to secure our existing work and see R3 further engaged with government departments and major businesses in promoting the work of the insolvency profession in the fight against fraud.

### Parliamentary engagement

A really important part of our work is engaging with parliamentarians, to promote the work of the profession and respond to issues and consultations.

Last year we responded to the Home Office consultation on anti-money laundering and counter-terrorist finance (see *RECOVERY* Autumn 2016 or visit **www.r3.org.uk/media/documents/publications/recovery/Autumn16.pdf** for more information), highlighting how some of the government's proposed changes would have made it harder for insolvency professionals and others to tackle fraud. We were pleased to see many of our recommendations taken into account in the government's consultation response.

R3 has also met with members of the House of Lords, including the victims' commissioner Baroness Newlove and chair of the National Trading Standards Board Lord Harris of Harringey. Both were keen to look at where the profession's powers can be promoted to the public and government agencies more widely.

### What next?

The group will continue to work closely with government agencies, parliamentarians and private sector organisations to ensure that the profession's role in tackling fraud is understood and used as widely as possible.

* This article should have been included in the previous 'Fraud' edition of *RECOVERY*, but was unfortunately missed due to an oversight.

R3's Fraud Group members are: Frances Coulson (Moon Beever); Louise Brittain (Wilkins Kennedy); Ian Defty (DDJ Insolvency); Richard Hooper (Haslers); Heath Sinclair (HS Alpha Limited); Stephen Baister (Chief Bankruptcy Registrar, High Court).

**FRANCES COULSON** is a senior partner at Moon Beever, a past R3 president and is chair of R3's Fraud Group.

# Advertisers' index



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An interview with...

# Kathryn Hiddleston

Matt Jukes speaks to **Kathryn Hiddleston**, tax specialist at Grant Thornton and member of the R3 General Technical Committee's Tax Working Group.

**Q What made you specialise in insolvency and restructuring tax?**

A There were not many people who specialised in insolvency and restructuring tax when I first started out and no one really wanted to deal with those cases. I was working at a firm when I was asked to look at a huge backlog of insolvency cases. I started to look through the backlog and began to work out how to deal with these cases and thought 'this is really interesting stuff', and that was how I ended up specialising in insolvency work. I found it much more interesting than mainstream tax work.

The interesting cases and the big recoveries of assets you could get at the time, and the irregularities that you find in tax in insolvency cases, are just fascinating.

**Q How did the tax group at R3 form?**

A I knew my opposites at the major firms and they used to meet periodically for a catch-up and a chat. I was invited to these meetings and, being a person who likes to move things along, ended up organising more meetings more regularly. We came across issues that needed to be brought to HMRC's attention and started to become a bit more active, though it was still informal. Then a member of the General Technical Committee approached us and suggested that we make it formal. We'd been having regular catch-ups with HMRC and it was the right time to do it.

**Q How has the tax group changed the relationship between the insolvency profession and HMRC?**

A What we can say is that insolvency had not been high on the agenda for HMRC for some time, largely because we'd been living in a benign economy for quite a while. IPs felt they weren't getting good service from HMRC and it was causing them problems fulfilling their duties and so on. However, it's a two-way street and HMRC was concerned that it was being bombarded with post and correspondence from IPs to a level that it couldn't handle. The question really was 'How can we find ways of reducing that correspondence, but also make sure that IPs are doing what they need to?'

There was an R3 survey early last year that showed IPs were generally not happy with the relationship. HMRC took it very seriously and asked what could be done to improve matters. We set up several R3/HMRC working party groups that have been meeting ever since to resolve the practical issues and to look at things that hadn't been considered before to improve and streamline the service from both sides. There's quite a good dialogue going with HMRC and we get fewer concerns raised by IPs.

> "HMRC has an ever decreasing workforce and needs to find new and better ways of policing taxpayers to ensure things run smoothly and effectively, and to take action when they don't."

**Q That sounds positive, so what's the biggest concern about interactions with the taxman at the moment?**

A There are lots of technical issues, but the biggest problem we have is with the resource cutting and budgetary constraints at HMRC. There are a lot of technical specialists coming up to retirement and there hasn't been a new bloodline brought in underneath, so the knowledge of distressed restructuring and »

## Kathryn Hiddleston biography

- Kathryn was the founder of the restructuring tax team for Grant Thornton UK LLP and has 25 years' of experience of this work. Her role includes providing restructuring and rescue advice to distressed businesses or those acquiring from distressed scenarios, giving both pre- and post-insolvency advice, and supplying forensic and investigation expertise in relation to UK and international tax. She co-ordinates the work of any area of tax relating to restructuring, insolvency or investigation including corporate, individual, VAT and customs duties, stamp and employment taxes.

- The R3 Tax Group started a few years ago as a series of informal discussions between Kathryn and like-minded professionals at other firms. Seeing potential in the group, R3 approached them and asked that they formalise their structure under the General Technical Committee to work with R3, the insolvency profession and HMRC to effect changes in policy and communications.

insolvency is not being passed on. Sometimes you've only got 24/48 hours to deal with a rescue and you need to talk sensibly to someone at HMRC to make sure that a proposed rescue plan will not result in unexpected or prohibitive tax charges. We've been lobbying hard for a resource to deal with these cases and large-scale rescues: a person who can deal with cases quickly, and who can look at proposed new tax legislation and make sure that it will work in rescue and insolvency situations.

> "Unless it's a charity I can't think of any case where tax wouldn't have an impact for a practitioner."

Tax specialists have to have the ability to do something if legislation is drafted in such a way that it precludes rescue because the proposal could create a massive tax charge that the other creditors and current lenders would not be willing to support. Likewise other creditors would be unfairly disadvantaged if legislation is drafted such that tax charges could be an expense in insolvency, ranking before other unsecured creditors. Our job is to try to make sure that we get the best for all creditors and, where possible, to see that a rescue isn't endangered by tax legislation.

**Q So there is still work to be done, but what has been the biggest success you've had so far?**

A The greatest win that I think we've had in recent years was when HMRC worked closely with the committee to create a corporate rescue exemption, which meant that when restructuring a business so that debt had to be released going forward, it wouldn't create a big tax charge in the insolvency. It took quite a long time to get that through, but that's probably the biggest thing that has happened alongside the fact that HMRC is more willing to consult on these things and listen to IPs as to what they need in future.

**Q What about the biggest challenge?**

A It's manpower at HMRC. The restructuring that began last autumn and will eventually result in the reduction of the number of offices from over 130 to just 13 major hubs (due to be finished by 2027) is difficult to deal with. Specialist units are already being relocated and some HMRC officers with good insolvency knowledge have decided that this is a good point at which to retire. So what's already beginning to happen is that the insolvency knowledge is lost, and there is a steep learning curve as new people have to deal with complicated insolvency matters. It's also a problem within the insolvency profession – you do have a lot of people moving out of it as there hasn't been the 'bread and butter' insolvencies that we have seen in the past.

**Q How would HMRC benefit from having a dedicated insolvency resource?**

A One of the messages we've got over to HMRC is 'don't just think about the money you'll get back immediately'. The IP is an essential part of the way HMRC is evolving. HMRC has an ever decreasing workforce and needs to find new and better ways of policing taxpayers to ensure things run smoothly and effectively, and to take action when they don't. What IPs do is investigate the activities of companies and individuals – they are a major tool for HMRC, as an external organisation looking at a case and spotting if something has gone awry.

Furthermore a large proportion of IPs deal with rescue of distressed restructuring cases. In such an instance it is better for HMRC to keep a viable business running so that you don't have mass unemployment in a particular sector, or so that you don't disrupt a sector such as nursing homes by shutting them down while you've still got elderly people in the homes. It makes economic sense for HMRC to keep viable businesses afloat as they will gain more tax going forward from this, not least from the employment taxes paid for continuing employees.

**Q How important are tax issues for the average insolvency practitioner/lawyer?**

A Unless it's a charity I can't think of any case where tax wouldn't have an impact for a practitioner. However, this comment has to be accompanied with the warning that 'the tail should not wag the dog'. When an IP is restructuring or dealing with an insolvency and trying to get the best recovery for creditors, tax cannot be the first thing to be thought of. However, it is vital for any commercial deal that the tax implications are considered at an early stage. I have seen instances where the tax status could render a deal commercially unviable.

**Q What are you most proud of in your career?**

A When I look back at what I've done the highlights tend to revolve around rescuing businesses that were in great danger of going under and lots of people losing their jobs and so on. It's a real buzz to rescue those businesses and be able to ensure something does continue, even though you can never name the businesses that you've rescued and invariably the employees have no idea that their jobs were ever at risk. When you work on such cases you're thinking very much about how big the impact is on people's lives. It could impact the workforce, or the local community, for example, as I said earlier with nursing homes. It's the people aspect of the profession that gives you the most satisfaction and is most important.

**Q Looking back over your career, would you change anything?**

A I would've started my career ten years or so later! From my point of view the work that I do now is even more exciting than it used to be. There's been a change to the rescue and investigation side, and there's an awful lot more investigation work arising from what HMRC is doing with its counter avoidance work. If I had started much later I could have been more involved in the forensic side of things, which I do a lot of now, just as I'm coming towards the end of my career.

> "It's a real buzz to rescue businesses and be able to ensure something does continue, even though you can never name the businesses that you've rescued."

**Q Tax can be an uncomfortable subject for an insolvency professional. What would you say to someone who is worried about dealing with it on a case?**

A Always consult and don't leave tax until the last moment! Don't assume that the deal will all be fine and that tax is only one small element of it. It is important to consult early on and within a reasonable time frame. Often tax is left until the last moment and it could be too late to change the deal and improve the situation. □

**MATT JUKES** is publishing manager of *RECOVERY* magazine.