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111.1 HMRC – Direct Recovery of Debts

- Legislation to enable HMRC to recover arrears of debts directly from taxpayers' bank accounts is included in the Finance Bill and will come into effect when the Bill receives royal assent.
- The legislation makes various amendments to the Insolvency Act 1986 to prevent HMRC from using the power to put itself in a preferential position in insolvencies.

The Finance Bill includes provisions giving HM Revenue and Customs power to take arrears of tax directly from taxpayers' bank accounts, as long as there remains a minimum overall balance of £5,000. The power will be subject to various safeguards including a county court appeal process and a face-to-face visit to every debtor before they are considered for debt recovery through this measure.

The Bill takes account of some of the points made by R3 in HMRC's consultation phase and makes various amendments to the Insolvency Act 1986 to ensure that the exercise of the new power does not deplete the assets available to creditors in liquidations and bankruptcies.

The following sections of the Insolvency Act are amended to extend their scope to cover the exercise of direct recovery powers by HMRC:

- Section 126 – power to stay or restrain proceedings against the company after presentation of winding-up petition.
- Section 128 – Avoidance of attachments etc. after commencement of winding up.
- Section 130 – No actions or proceedings may be commenced or proceeded with after making of winding-up order or appointment of provisional liquidator.
- Section 176 – Preferential debts charged on goods distrained within three months of winding-up order, which will now include payments made to HMRC under the direct recovery powers.
- Section 183 – Creditor not entitled to retain benefit of execution or attachment unless completed before commencement of winding up, or after receiving notice of meeting to pass a resolution for voluntary winding up.
- Section346 – Creditor not entitled to retain benefit of execution or attachment unless completed before commencement of bankruptcy.
- Section 347 – Preferential debts charged on goods distrained within three months of bankruptcy order, which will now include payments made to HMRC under the direct recovery powers.

With regard to the other statutory protection provisions contained in the Insolvency Act, HMRC have confirmed that in their opinion the expression 'legal process' is sufficiently broad to cover the direct recovery of debts process without the need for amendment in the following cases:

Company voluntary arrangements

- Schedule A1, paragraph 12(h) – Effect of moratorium

Administrations

- Schedule B1, paragraph 43 – Moratorium during administration.

- Schedule B1, paragraph 44 – Moratorium where an administration application has been made or notice of intention to appoint has been filed but the appointment has not yet been made, or the application dismissed.

Individual voluntary arrangements

- Section 252 – Effect of interim order.

- Section 254 – Power of court when application is made for an interim order.

There remain concerns over the practical implications of the new power, such as the impact of the £5,000 threshold on a trading business' cash flows and the accuracy of the underlying debt being pursued, which we will continue to explore with HMRC.

The new powers also give rise to concerns in corporate restructurings in circumstances of financial distress, where there is unlikely to be a question of deliberate tax avoidance. The risk that the power may be used if the company is on the verge of insolvency and HMRC may adopt a less conciliatory stance, will put a company in a weak position and raise concerns that its cash resources may be depleted by HMRC action. This could put the viability of any restructuring plan in doubt.

The detailed provisions are set out in Schedule 8 to the Finance Bill, to which members should refer.

111.2 Corporate Rescue Exemption from Tax on Release of Debts

- Under provisions contained in the Finance Bill, credits which arise when debts of companies in financial distress are released or modified will be exempt from tax in 'corporate rescue' situations.

- The Finance Bill also introduces provisions such that if a debtor and creditor become connected in a 'corporate rescue' situation, a taxable 'deemed release' may not arise.

- The provisions are due to come into effect on the date that the Bill receives royal assent.

In normal circumstances, credits which arise when a loan relationship is released are subject to charge to corporation tax (except where the parties are connected or the release is part of a statutory insolvency arrangement, a formal insolvency process, or in some circumstances the debt is exchanged for equity).

Under new provisions contained in the Finance Bill, accounting credits arising when debts of companies are released or modified will be relieved from the charge to tax in certain distressed situations. The new provisions provide that:

- The release of a debt, or a modification or replacement of a debtor relationship, will not be required to be brought into account if, immediately before the release, modification or replacement, it is reasonable to assume that, without the release, modification or replacement, there would be a material risk that at some time within the next 12 months the company would be unable to pay its debts.[1]

[1] s. 322 CTA 2009 as amended by Finance Bill Sch 7; s. 323A CTA 2009 as inserted by Finance Bill Sch 7.

In some circumstances where a debtor and creditor become connected, taxable deemed releases can arise in relation to impaired debt. In particular, this can apply where (i) a company is a party to a loan relationship as the debtor and a company that is already connected with the debtor acquires the loan at a discount such that it becomes the creditor; or (ii) the debtor company and creditor company to a loan relationship become connected. The Finance Bill has introduced an exemption for 'corporate rescue' situations such that:

- Where the debtor company and creditor company to a loan relationship become connected, and the creditor company releases the debtor's liability under the loan relationship in whole or in part, the amount released will not be brought into account for tax purposes if the release is made within 60 days of (i) the acquisition of the loan; or (ii) the companies becoming connected, provided the corporate rescue conditions are met. The corporate rescue conditions are –

  - that the debt was acquired or the companies became connected as a result of an arm's length transaction, and

  - that immediately before the debt was acquired or the parties became connected it was reasonable to assume that, without the transaction, there would be a material risk that at some time within the next 12 months the debtor company would have been unable to pay its debts.[2]

- For all the above purposes, a company is unable to pay its debts if –

  - it is unable to pay its debts as they fall due, or

  - the value of the company's assets is less than the amount of its liabilities, taking into account its prospective and contingent liabilities.[3]

These provisions are due to come into effect on the date that the Finance Bill receives royal assent and will not, as previously thought, be backdated to 1 January 2015.

Members should refer to the legislation for the detailed provisions.

111.3 Fees – Pension Protection Fund Guidance

- The Pension Protection Fund has issued internal guidance on its approach to approving insolvency office holders' fees.

The Pension Protection fund has issued a guidance note on its policy and practice as a creditor when approving insolvency office holders' remuneration. The guidance note also deals with the PPF's approach to pre-packs, and the situation where security is held by the pension scheme trustees.

The guidance note is available on the PPF website at:

http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/IP_remuneration_May2015.pdf

[2] s. 362A CTA 2009, as inserted by Finance Bill Sch7.
[3] s.322 CTA 2009 as amended; ss. 323A and 362A as inserted.

111.4 Health and Safety for Office Holders and the Construction (Design and Management) Regulations 2015

- Two new guidance notes are available on the R3 website.

The Construction (Design and Management) Regulations 2015 (SI 2015/51) came into force on 6 April 2015 with the purpose of ensuring construction work and repairs are undertaken safely and without damaging workers' and other people's health. Failing to comply with the requirements is a criminal offence, punishable with unlimited fines and, for individuals, imprisonment and therefore care must be taken.

R3 has produced a guide to the new Regulations, which is available in the members' section of the R3 website.

The HSE has also published draft guidance on the Regulations, which can be accessed at the following link:

http://www.hse.gov.uk/pubns/priced/draft-l153.pdf

R3 has also produced a general guide on health and safety for office holders, which is available on the website.

Members should note that these guides are for information purposes only and do not constitute legal advice. Members should take their own advice on individual cases.

111.5 Conditional Fee Agreements do not Infringe Human Rights

- The Supreme Court held that the system of funding litigation by means of conditional fee agreements and after the event insurance established by the Access to Justice Act 1999 is compatible with the European Convention on Human Rights.

Members will be aware that conditional fee agreements and after the event insurance continue to be available for the time being for use by office holders in formal insolvency proceedings – see Technical Bulletin 109.4.

In the recent case of *Coventry & Ors v Lawrence & Anor* [2015] UKSC 50 The Supreme Court considered whether the conditional fee regime was incompatible with the European Convention on Human Rights. Although it was not an insolvency case, it is likely to be of interest to insolvency practitioners.

The underlying proceedings concerned a claim in nuisance by owners of a bungalow against the operators of a nearby stadium used for motorsports. The claimants were successful in their nuisance claim on appeal to the Supreme Court. The claimants funded their action by means of a conditional fee agreement. The respondents were ordered to pay 60% of the claimants' costs. This meant that as well as having to pay 60% of the claimants' base costs, the respondents also had to pay 60% of the success fee and the after the event insurance premium, which together amounted to £312,000. The Respondents accepted that they could not challenge their liability for the base fees (subject to any challenge to the claimants' bill of costs), but challenged their liability to pay the success fee and ATE premium on the basis that this would infringe their rights under article 6 of the Convention (which protects the right to a fair trial), and/or article 1 of the first protocol to the Convention (which protects the right to peaceful enjoyment of ones possessions).

By a majority of 5-2, the Supreme Court held that the Access to Justice Act regime (and particularly the secondary legislation under which it operates) is compatible with the European Convention on Human Rights. Lords Neuberger and Dyson held that, by reference to the generality of cases, the access to justice arrangements was justified by the need to widen access to justice following the withdrawal of legal aid, was made following wide consultation and fell within the wide area of discretionary judgment afforded to legislature and rule makers. There was, they said, no perfect solution to the problem of how best to enhance access to justice.

In a dissenting judgment, Lord Clarke argued that the Access to Justice Act regime was disproportionate because it did not treat all defendants in the same way but chose a particular class of defendants to impose liabilities far beyond the bounds of what was reasonable or proportionate. This was a case where a measure was discriminatory in a way that was incapable of objective justification.

For the Court's reasoning in full members should refer to the text of the judgment, which is available on the Supreme Court website at:

https://www.supremecourt.uk/cases/uksc-2012-0076.html

111.6 Conditional Fee Arrangement not Available in Special Administration Regime

- The High Court held that an investment bank special administration did not benefit from the exemption from the Jackson reforms which applies to general insolvency proceedings.

Insolvency litigation is currently exempt from the provisions of the Legal Aid Sentencing and Punishment of Offenders Act 2012 which would have prevented full cost recovery in cases brought by insolvency office holders funded by conditional fee arrangements. The exemption applies to 'proceedings brought by a person acting in the capacity of an administrator appointed pursuant to the provisions of Part II of the 1986 Act', or 'proceedings brought by a company which has entered administration under Part II of the 1986 Act', the '1986 Act' being the Insolvency Act 1986.

Administrators were appointed to Hartmann Capital Limited under the investment bank special administration regime. The administrators sought a declaration which would establish that they were entitled to take advantage of the funding regime which applies in relation to insolvency proceedings generally. However, the administrators were not appointed under the 1986 Act, but under the Investment Bank Special Administration Regulations 2011. The special administration regime did not fall within the ambit of the exemption, and the administrators were therefore not able to take advantage of the funding opportunities available under a conditional fee arrangement.

Re Hartmann Capital Limited [2015] EWHC 1514 (Ch).

The full text of the judgment is available on the British and Irish Legal Information Institute website at:

http://www.bailii.org/ew/cases/EWHC/Ch/2015/1514.html

111.7 IVA – Funds Received After Issue of Certificate of Completion

- The High Court held that proceeds of a PPI compensation claim received after the issue of a certificate of completion of an IVA should be paid to the debtor and not paid to the supervisor for the purposes of the arrangement as the effect of completion was to release the debtor from his liabilities with the consequence that creditors were no longer to be treated as creditors for the purposes of the arrangement.

- Members should however note that the decision is subject to appeal to the Court of Appeal (date to be confirmed).

In August 2007, Mr Wright ('the debtor') proposed the terms of an individual voluntary arrangement (IVA), incorporating the R3 Standard Conditions (version 2), which was approved with some modifications. The debtor complied with his obligations under the terms of the IVA. In January 2013, the supervisor reported to the creditors that the debtor had fully complied with his obligations and issued a certificate of due completion, under paragraph 9 of the Standard Conditions. In September and October, the debtor received two payments from banks, totalling some £24,500, which were the proceeds of payment protection insurance policies that had been mis-sold to him. In July 2014, the supervisor issued an application to the county court for directions as to whether the funds should be distributed in accordance with the terms of the IVA or be paid to the debtor. The county court declared that the funds should be paid to the debtor. The supervisor appealed.

The issue for determination was whether the county court had erred in law in construing the terms of the Standard Conditions in such a way that the effect of the supervisor having served the completion certificate, within paragraph 9(2) of the Standard Conditions, had been to conclude the IVA.

Judge Hodge QC in the Manchester District Registry dismissed the appeal. Paragraph 9(2) of the Standard Conditions meant that the debtor was released from all debts which were subject to the arrangement. That could only mean that the creditors were no longer to be treated as creditors for the purposes of the arrangement. Once the arrangement had been satisfactorily concluded by the issue by the supervisor of a completion certificate, the debtor was released from all debts subject to the arrangement. That release applied for all purposes of the arrangement and brought an end to the trusts affecting the arrangement. Accordingly, the county court had reached the correct conclusion. In short, the IVA had come to an end.

In this case the proposals were silent on whether or not a trust continued after completion of the arrangement, and no express agreement had been reached with the debtor regarding the treatment of PPI compensation payments.

It was argued for the supervisor that, following the reasoning of the Court of appeal in *NT Gallagher & Son Ltd* [2002] EWCA Civ 404, the trusts imposed by the terms of the IVA continued after the issue of the completion certificate, and that to the extent that there were uncollected assets that were arrangement assets within the IVA, and because of the continuing trusts, the supervisor remained obliged to collect them and distribute them in accordance with the terms of the IVA.

The judge rejected this argument. The *Gallagher* case was of no assistance, because it concerned a voluntary arrangement for the benefit of the arrangement creditors, which failed, and the issue was whether, in those circumstances, the trusts created by the arrangement automatically terminated. The Court of Appeal was considering the position on failure of the arrangement, and not upon its completion.

However, members should note that the decision is subject to appeal to the Court of Appeal.

Depending upon the terms of the voluntary arrangement this decision may raise potential difficulties for supervisors of voluntary arrangements where the arrangement is shortly due to end, not only in cases where there are unrealised assets but also where there are undistributed funds.

Members acting as supervisors in voluntary arrangements where these circumstances apply may wish to consider what steps can be taken to overcome the potential problems arising from this judgment both with regard to existing voluntary arrangements and with regard to the drafting of future proposals.

Green v Wright [2015] EWHC 993 (Ch)

The full text of the judgment is available on the British and Irish Legal Information Institute website at:

http://www.bailii.org/ew/cases/EWHC/Ch/2015/993.html

111.8 Companies Act Schemes – Need for Full Supporting Information

- The High Court recently emphasised the need for full supporting information when presenting a proposal for a scheme under Part 26 of the Companies Act 2006.

At a recent hearing sanctioning schemes of arrangement in respect of a group of Dutch and Belgian companies, the judge emphasised the need for the provision of detailed supporting material by those proposing a scheme.

In the present case the scheme companies did not have their centre of main interests, or any establishment, or any significant assets, in England. The schemes were part of a restructuring of the group's financial indebtedness, the terms of which were governed by English law. The restructuring was urgently needed, as the group was unable to comply with its financial covenants.

Snowden J said that even in a case where there was considerable commercial imperative, and even where the scheme in question was supported by an overwhelming majority of the creditors, the court does not act as a rubber stamp. In the present case, the evidence was that if the schemes were not approved the group would be likely to collapse into a series of insolvency proceedings in the Netherlands and Belgium, and that this would lead to a materially worse return to scheme creditors than under the proposed schemes. However, there was no detailed material provided either to the creditors or to the court in support of these contentions as to the alternatives to the schemes.

Snowden J said: 'I would, however, indicate for the future that companies that seek the consent of their creditors and the sanction of the court to a scheme of arrangement that is put forward as a more advantageous outcome for creditors than formal insolvency proceedings may be well advised to ensure that greater detail is provided, both in the Explanatory Statement and in the evidence before the court, as to the possible alternatives to the scheme and the basis for the predicted outcomes. The provision of such information is likely to be essential if there is a challenge to the scheme.' (para. 24 of the judgment)

Re Van Gansewinkel Groep BV & Ors [2015] EWHC 2151 (Ch)

The full text of the judgment is available on the British and Irish Legal Information Institute website at:

http://www.bailii.org/ew/cases/EWHC/Ch/2015/2151.html

111.9 Collective Redundancies and Meaning of 'Establishment' – CJEU Judgment

- The Court of Justice of the European Union has released its judgment in the case of USDAW and Wilson (C-80/14).

The case arose from the insolvency of Woolworths and Ethel Austin and concerns the meaning of the term 'establishment' in section 188 of the Trade Union and Labour Relations (Consolidation) Act 1992 (TULRCA). Section 188 requires an employer to consult where it proposes to dismiss as redundant 20 or more employees at one establishment. TULRCA is derived from Article 1(1)(a) of the European Collective Redundancies Directive (Directive 98/59/EC).

The Employment Appeal Tribunal, overturning the decision of the Employment Tribunal, had held that the UK legislation did not reflect what the Collective Redundancies Directive had intended. The EAT held that the duty to consult with employees applies where an employer proposes to dismiss 20 or more employees irrespective of where the employees are located, and that it is irrelevant how many are employed at any one establishment.

The CJEU took a different view, and held that it is the entity to which the workers made redundant are assigned to carry out their duties that constitutes the 'establishment' for the purposes of Article 1(1)(a) of the Directive, and that the relevant provisions should not be interpreted so as to require account to be taken of the total number of redundancies across all the establishments of an undertaking.

The judgment is available on the Curia website at:

http://bit.ly/1IYVhG5

or

http://tinyurl.com/p6o9azl