Using a restructuring plan to compromise HMRC: risks post-Petrofac

Following HMRC voting in favour of, and actively supporting at Court, two successive restructuring plans (**RP**) where tax claims were expressly compromised (*Enzen* and *OutsideClinic*), the first half of this year appears to have marked a positive sea-change in terms of the prospects for the so-called "mid-market" RP: from near inevitable HMRC challenge towards proactive engagement, and even support. Companies now have a path to HMRC support.

Of the seven RPs involving liabilities to HMRC prior to *Enzen* and *OutsideClinic*, HMRC voted against four RPs (*Prezzo*, *GAS*, *Nasmyth* and *Houst*) and actively challenged three (*Prezzo*, *GAS* and *Nasmyth*). At the sanction hearings in *Enzen* and *OutsideClinic* however, HMRC indicated that they will now be adopting a proactive approach to engagement with RP companies, and will participate as fully as they are able, supporting doing "*deals with companies in the right circumstances where the deal is the right deal*". Previously, the risk, cost and impact on cash burn and time "runway" associated with defending the seemingly inevitable in-Court challenge from HMRC (with unpaid tax often a significant exposure, the compromise of which a likely core driver of a mid-market RP) had been one of the primary reasons why mid-market corporates could not get plans, otherwise capable of right-siding their balance sheet, off the ground.

Executive summary:

1) The basis upon which HMRC will support an RP should not be confused with what HMRC are fairly entitled as a creditor / how their claims can be compromised by an RP in the circumstances. The restructuring industry should be wary of allowing HMRC to elevate the nature of case-by-case uplift deals to the level of what "must" be done in all cases.

2) HMRC's newly supportive stance was built in great part on how they have extracted premiums to their proposed returns in exchange for support:

    a. Query whether such uplifts at the gift of senior classes and new money can regularly withstand scrutiny post *Petrofac*: it may prove increasingly difficult to demonstrate that one out of the money class (such as HMRC in *OutsideClinic*) merit additional payments (or the "gifting" of restructuring benefits) not on offer to other out of the money / compromised classes. Activist landlord classes, not offered such payments, may see it as a ready basis for attacking RPs on a "fairness" basis.

    b. The solution will in part be to have robust valuation evidence, resting on firm assumptions, showing who is and who is not in the money, alongside a "plan benefits report" showing that the returns projected for HMRC are "fair" and best case from the beginning (in this case

building in uplifts for HMRC at the outset on the basis of fair allocation of RP benefits, following active and early negotiation with HMRC). HMRC will likely need to come to terms with that state of affairs: engage early or risk being unable to secure later uplifts payments for fear of challenges to "gifting" post Petrofac. That likelihood may actually assist in obtaining certainty of an early deal with HMRC.

3) An interesting logical extension of HMRC's activist support of RPs is that we may even see HMRC becoming an occasional driver of class and voting dynamics in partnership with the RP company. "Locking-up" HMRC support may prove key to how companies can drive mid-market RPs more effectively, and even "cram-up" secured creditors or at least better sensitise demands from financial creditors and new-money. The mid-market style RPs that are more likely to require meaningful Court interaction are those that HMRC does not in fact support.

4) We provide a high-level guide to managing interactions with HMRC with a view to either their supporting an RP, or the Court sanctioning the RP and imposing the terms on HMRC.

HMRC's new stance is built upon extracting negotiated premiums / ransom payments

Crucially, it is not that HMRC accept that they were wrong not to have supported historic RPs that sought to compromise them; rather, the position now taken is essentially that HMRC will support a properly formed RP that effects what they see as a fair deal. Viewed that way, this "new" approach is driven by two key factors: (1) restructuring industry advisors have solved for failings in approach under older RPs, having now presented more palatable deals to HMRC; and (2) HMRC dropping their stance of voting in principle against any RPs that allow a plan company to either have traded "at their expense" in the lead up to the RP, or compromise their preferential rights (VAT, NIC etc.) / alters their relative waterfall priority to other creditors on the basis that they should be afforded a unique status as an "involuntary" creditor and public tax collector. Taken together, the rescue culture for the mid-market benefits greatly.

Ultimately, the essential lessons from the March 2025 sanctions of the *Enzen* and *OutsideClinic* RPs are that HMRC will vote in favour of and actively support RPs: (1) that involve a fair (in their mind) distribution of the value (aka. surplus or benefits) created by the RP to them; (2) which recognise their supposedly unique status as an involuntary creditor (who cannot withdraw credit in the same way given ongoing trading) to whom a plan company owes lawful tax collection obligations by way of a premium (some would say "ransom") payment; and (3) where the RP company is compromising only historic tax claims, and has (for example since the launch of material restructuring discussions) been keeping tax payments current and not "trading at the expense of" HMRC (e.g. using collected tax monies (VAT, NIC, PAYE) to instead pay key suppliers to support trading).

HMRC's newly supportive stance is however built in great part on how HMRC has extracted premiums to their proposed returns in the projected insolvencies in exchange for support. They have leveraged their supposedly unique status to help re-price their claims to the restructuring surplus. The question remains as to whether that premium is justified as reflecting the "fair" allocation of the benefits of the RP, or whether it is simply better viewed as a ransom payment involving HMRC receiving more than their "fair" share. HMRC's positive vote was procured in *Enzen* between convening and sanction by way of HMRC negotiating an additional £200,000 aggregate payment across both plan companies. Whereas, in *OutsideClinic*, HMRC received an additional payment of 10p in the £ (in their capacity as a preferential creditor), on top of the 5p in the £ offered to the unsecured creditors not having priority status (despite valuation evidence showing a nil return to HMRC in an insolvency).

Previously, such active HMRC negotiation on RPs was not forthcoming. This will of course rarely be possible for most true "mid-market" RP, where the plan company will likely be close to the very edge. These extra funds in *OutsideClinic* were for example funded by shareholder new money (permitted or "gifted" by the secured creditor, to help preserve the secured return) as opposed to the pool of company funds otherwise available to unsecured creditors.

Are HMRC "unique" or simply entitled to a fair allocation of restructuring benefits?

In the context of the special status seemingly afforded to HMRC under the *Nasmyth* RP (who are to be treated with "caution" and only compromised with "good reason"): on the one hand, the Judge in that case specifically highlights that HMRC can be crammed down in principle, that HMRC does not have the statutory power (as it does in CVAs) to veto any compromise of its preferential claims, and is not granted any particular statutory priority in the context of RPs; but, on the other hand, seems to nevertheless elevate HMRC to a more favoured position than that of an otherwise commercial creditor in spite of there being no legislative basis in Part 26A of the Companies Act or otherwise for the Court to do so. The authors query whether this policy stance is justified in the absence of statutory direction and in the face of the conscious decision by parliament to not block cram down being imposed on preferential tax claims in an RP in the same manner as they already do in a CVA by contrast.

The more principled approach may be to focus on the fact that any 'in the money' involuntary creditor may be liable to be treated cautiously by the Court (especially in situations where there a particularly unequal allocation of the "restructuring surplus"). The question ought not be whether HMRC are special, it should simply be whether they are receiving their "fair share" of the restructuring benefits only – those questions are two sides of the same coin and should not be treated as different line items in any analysis. HMRC are "unique" only in that their contribution to the restructuring surplus can prove unique given their involuntary creditor status (they cannot withdraw credit in the normal way). The question should therefore be: how do you value that contribution (e.g. forbearance and time to pay) not whether there should be an added premium generated by un-legislated for Judge driven policy concerns. Robust valuation evidence and a "plan benefits report" will be essential (i.e. either this is the relevant alternative to the RP, and a fair allocation of the restructuring surplus, or it is not).

The risk of paying uplifts to HMRC following the Petrofac ruling

HMRC will, not unlike any rational creditor, leverage its position to increase its return (*Prezzo* also involved increased payments to HMRC offered post RP launch). That is not to say that the *Enzen* / *OutsideClinic* model is the only form of RP that the Court will sanction in terms of cramming down HMRC. Rather it is what HMRC will or, at least, have supported (albeit they voted against in *Prezzo*, a case prior to the new change in approach). And there are, of course, strong commercial reasons for any RP company to have HMRC onside (reducing the time, costs and expense of an activist HMRC challenge and increasing execution certainty and pushing the savings into productive turnaround efforts and surplus).

It is the author's view that HMRC are however coming close to overplaying their hand / supposed special status. After the *Prezzo* RP, it remains clear that the basis upon which HMRC will support an RP should not be confused with what HMRC are fairly entitled as a creditor / how their claims can be compromised by an RP in the circumstances. The restructuring industry should be wary of elevating, or allowing HMRC to elevate in the mind of the Court and companies seeking turnaround solutions, the nature of case-by-case uplift deals done with HMRC, to the level of legal precedent / what "must" be done for HMRC's benefit, especially if the arguments made above, as to why this special status may not be justifiable, have weight.

Petrofac confirms that if an RP includes any special benefits or incentives (in this case in the form of uplift payments to HMRC), they must be properly justified (including as to why one out of the money class receives added value but others do not) and explained. The normative basis for paying uplifts / ransom payments to HMRC may not always be clear. In any future RP, where evidence shows HMRC to be out of the money on their preferential claims (similar to *OutsideClinic*), any RP company should give careful thought to how they can justify treating HMRC differently to unsecured creditors: why should HMRC receive any special treatment, or "gifting" of value from the secured class for example, if there are no

assets to distribute to HMRC at that level of the waterfall in the first place? The industry should beware arguments from HMRC that their so-called special status supports gifting of value to them / uplift payments as a standard condition of their support when they are out of the money. Why should, for example, unsecured claimants get less or no such uplift because, had there been value to distribute, HMRC would have received it?

In *OutsideClinic*, the valuation evidence on its face projected a nil return to HMRC. The plan company acknowledged that a relatively small shift in the assumptions as to recoverability of book debts and expenses would give rise to a situation in which HMRC would also be in the money (secondary pref. claims being carved out of floating charge returns in the waterfall). The court accepted that submission from the company: "*OutsideClinic has been realistic enough to acknowledge the likelihood of HMRC being shown to be an in the money creditor on a contested application, and on that basis the parties have negotiated an improved outcome for HMRC (the HMRC Dividend), which the Investors have agreed can be funded from the new £2m they are advancing*." Certain observations arise:

1) Liquidity was extremely tight in *OutsideClinic* and the absence of the traditional mid-market class of aggravated landlords (all landlords here voted in favour in respect of modest compromises) seeking similar ransom payments gave HMRC the whip hand.

2) HMRC will however not always be the only "out of the money" creditor party to such negotiations, and in more complex mid-market structures involving (for example) active landlord constituencies being materially crammed down, this "gifting" of returns by (for example) new money shareholders to preferential creditors like HMRC (who the company's own valuation evidence shows will receive zero in the alternative insolvency) will no doubt be controversial. Petrofac confirms that if an RP includes any special benefits or incentives (in this case in the form of uplift payments to HMRC), they must be properly justified (including as to why one out of the money class receives added value but others do not) and explained.

    a. Landlords, who as an industry view RPs and CVAs as forcing them to create value for other classes and investors, through compromised leases, without that pain being adequately compensated, will no doubt query whether this selective "gifting" of value is permissible, and will argue that the new money should equally contribute to their class to produce a fair result and stave off challenge. The *Virgin Active* line of cases (supporting "gifting" on the basis that the business and assets of the RP company belong (in economic reality) to the in-the-money creditors, establishing that it is for those creditors to determine how to divide up any restructuring benefits) were overturned in Petrofac. The *Thames Water* and *Petrofac* Court of Appeal rulings show that simply providing *de minimis* returns to out of the money classes (such as landlords in this example) will not be enough and that such classes cannot fairly be excluded from the benefits of a restructuring.

    b. The payment of uplifts / ransom payments to HMRC in this way (especially where HMRC are out of the money) is a likely source of challenge by landlords and others post *Petrofac*, meaning such payments (as "benefits" of the restructuring) will attract obvious scrutiny, especially so where *Petrofac* makes it clear that the plan company must make genuine attempts to negotiate with all of its creditors. Query whether there will be any leeway for smaller-cap RPs where the resourcing, time and material cash burn of broad-based negotiations (including with out of the money classes) may undermine the cost-base of the planned RP itself.

3) The solution to the problem of the RP company having to guard against claims of unjustified "gifting" of restructuring benefits to HMRC will in part be to have robust valuation evidence, resting on firm assumptions, showing who is and who is not in the money, alongside a "plan benefits report" showing that the returns projected for HMRC are "fair" and best case from the beginning (in this case building in uplifts for HMRC at the outset on the basis of fair allocation of the surplus, following active and early negotiation with HMRC). HMRC will need to come to terms with that state of affairs: engage early or risk being unable to secure later uplifts / ransom payments for fear of challenge to "gifting" post *Petrofac*.

We describe below the further lessons from the case law with respect to how best to employ an RP to compromise preferential and unsecured tax liabilities.

"Locking up" HMRC in support to help drive the RP?

It is worth highlighting at the outset however an interesting logical extension of HMRC's activist support of RPs in this way: we may even see HMRC becoming a driver of class and voting dynamics in partnership with the RP company, and perhaps even the cross-class cram down of lenders and others by HMRC votes going forward. Locking-up HMRC in advance may prove key to how plan companies can drive "mid-market" RPs much more effectively, and even "cram-up" secured creditors (use HMRC's support to try to compel support from senior lenders) or at least better sensitise demands from financial creditors and new-money equity constituencies. Paradoxically, we may even fail to see a material uptick in Court reported RPs that compromise HMRC in the mid-market if bilateral deals can be consummated with a now (in principle) supportive HMRC and one's financial creditors and new money, and where any RP may have kept key suppliers whole in any event (potentially isolating the typical landlord class). That will all rest on three key factors:

1) Timing and breathing space: the plan company having sufficient cash runway and creditor stretch to create the time and space for negotiations and / or trial, and to help it best evade any disruptive winding up petitions landing in the interim;

2) Credible threat of an RP and valuation sharing: the plan company having a credible draft RP in waiting, which can be finalised and pushed forward quickly by advisors who will have already performed the full "relevant alternative analysis" and shared that with HMRC (acknowledging the cost to an SME of doing so); and

3) Offering the best deal to HMRC at the outset: an RP company putting is best foot forward with HMRC early, offering up the best deal it can on tax liabilities (i.e. either this is the relevant alternative to the RP, and a fair allocation of the restructuring surplus, or it is not) – and where the significant time and cost savings achieved in the mid-market from not having to run an RP to conclusion may instead be distributed in part to HMRC as an incentive to agree.

On that logic, the mid-market style RPs that are more likely to require meaningful Court interaction are those that HMRC does not in fact support.

How to use an RP to compromise preferential tax liabilities

The below is a high-level guide to managing interactions with HMRC with a view to either their supporting an RP that compromises tax liabilities, or the Court sanctioning the RP and imposing the plan on HMRC (by way of "cross-class cram down").

Whilst not all of the below may be strictly required to achieve support, and less are required to actually secure Court sanction, they provide a suggested outline approach:

1) Open negotiations / contact early in the planning for any RP, offering the best deal available to HMRC at the outset, acknowledging their particular status. Prepare for negotiation and respond to HMRC counter-proposals;

2) Provide a robust financial model of the "relevant alternative", with defensible assumption, and fairly allocating the "restructuring surplus", including to HMRC:

    a. Allow HMRC participate in future value projected to be created by the RP if successful: where the restructuring will right-size a business and allow it to trade profitably in future, the Court may expect HMRC to be able to capture that future value in tax receipts to offset historic

losses and reflect the value of HMRC's forbearance and agreement to terms / compromise via the RP. It also has an anti-embarrassment feature for HMRC.

b. HMRC's value contribution can be varied: e.g. forbearance, allowing the RP to launch and not issuing a winding up petition, has value in itself and contributes to the success of the RP (as acknowledged in *Nasmyth*, and should be provided with a pound value figure in the valuation). HMRC treatment in *Enzen* and *OutsideClinic* further reflected the standing of HMRC as preferential creditor; the commercial leverage that it is able to exert in consequence of Naysmyth and GAS; and the inevitability of an ongoing relationship as trading continues.

3) Where possible, compromise only defined historic tax claims, and keep tax payments "current" (for example since the launch of material restructuring discussions);

4) If continuing to trade without keeping HMRC payments "current", be prepared to carefully justify payments to genuinely "critical" creditors;

5) Take advantage of the Court's case management powers (requiring challenges from HMRC for example to be notified by a specific time pre-hearing) to help drive tight timelines;

6) Do not present an RP to the Court that requires HMRC ongoing support (e.g. any time-to-pay deal negotiated outside the RP) without having that support locked in in advance; and

7) Be prepared for HMRC challenge, even if HMRC are "out of the money": prepare to scrutinise HMRC's own valuation evidence: to effect a challenge, HMRC must typically present its own valuation evidence and will seek disclosure of valuation evidence to it to allow it build a competing report (which the Court will facilitate, such as in the convening hearing in *OutsideClinic*).

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