

Newman & Partners

Licensed Insolvency Practitioners

RECOVERY & REVIVAL BULLETIN

Welcome to the latest issue of our Recovery and Revival Bulletin, designed to keep you up-to-date on insolvency matters that may be of interest to you. If you have any feedback on this bulletin, or would like to know more about our services or how we can help you, please contact us on **020 8357 2727** or at insolvency@newmanandpartners.co.uk

Crown Preference – Paying the King in times of insolvency

Insolvency often leaves creditors competing for limited funds and, if you are an accountant advising your client, understanding HM Revenue and Customs' (HMRC) position as a creditor is critical, especially after the reintroduction of Crown Preference in December 2020. This change elevated some tax debts, such as VAT, PAYE, and employee National Insurance contributions, to secondary preferential status, ahead of unsecured creditors.

Crown Preference does not cover all taxes, however. Corporation Tax and employer National Insurance contributions remain unsecured debts. This distinction is important, as it directly affects how much unsecured creditors can expect to recover.

The impact is, arguably, most significant for directors of struggling businesses. When HMRC holds a large preferential claim, the financial viability of the company can be severely undermined. Directors must tread carefully, as trading while insolvent risks accusations of wrongful trading. As accountants, you play a vital role in helping directors understand these risks and assessing whether continued trading is realistic.

HMRC's aggressive approach to debt recovery adds further pressure. It is often the first to issue winding-up petitions, using Crown Preference to bolster its position. Negotiating with HMRC is rarely straightforward, and the preferential status of certain debts leaves less room to manoeuvre for other creditors.

Many trade creditors that once expected some recovery in insolvencies now find themselves with nothing because of Crown Preference. This makes credit decisions riskier, particularly when dealing with companies carrying large tax liabilities. You must therefore advise your clients to scrutinise their financial health before extending credit.

The key for accountants is clarity. You must help your clients understand the priority of debts, set realistic expectations, and act promptly in cases of insolvency.

Crown Preference has tilted the balance heavily in HMRC's favour, leaving less for unsecured creditors. Advising your clients on how this affects their position is your most important job.



For help managing this, **please get in touch with our insolvency practitioners.**



Why are construction insolvencies so prevalent?

Construction insolvencies remain disproportionately high, accounting for 16.2 per cent of all insolvencies in England and Wales in September 2024. This equated to 292 registered construction businesses closing their doors that month alone. Over the 12 months to September 2024, the total number of construction insolvencies reached 4,264 – a small dip from the previous year but still a stark 32.5 per cent increase on pre-pandemic levels in 2019.

Low margins and high volatility

The construction sector is notorious for its razor-thin profit margins. Many firms operate on fixed-price contracts, locking in costs at the outset, only to face rising expenses as projects progress.

While material cost pressures have eased slightly in recent months, the inherent unpredictability of the construction process – delays, design changes, and unforeseen site conditions – continues to create financial instability. Even minor deviations from planned costs can erode profits entirely, leaving businesses with little to absorb unexpected shocks.

Cash flow challenges

Cash flow management is a perennial issue for contractors and subcontractors alike. The payment structure in construction, which often involves delayed payments and retention sums held until project completion, places immense pressure on smaller firms.

Subcontractors, in particular, are vulnerable when payments are delayed higher up the supply chain. This creates a cascading effect, as firms struggle to meet their own financial obligations, leading to defaults and, ultimately, insolvency.

Risk management failures

Analysis by **EY-Parthenon** highlighted the importance of robust risk management across the contract lifecycle, from pricing to delivery. However, slippages in these disciplines remain common.

Poor forecasting, inadequate internal controls and failure to address emerging issues early can quickly turn into larger financial problems. When clients, creditors, or stakeholders lose confidence, it can spell disaster for a firm already teetering on the edge.

Trade credit insurance and bonding pressures

The high insolvency rate in the sector has dampened appetite for trade credit insurance and bonding. Where these are available, they come at a higher cost and with greater scrutiny. This creates a vicious cycle, as firms already under financial strain face increased difficulty securing the assurances needed to win new contracts. Without these protections, the financial risks of operating in the sector only increase.

Hardest hit activities

Specialised construction activities – such as demolition, site preparation, and finishing trades like plastering and glazing – have been consistently overrepresented in insolvency statistics.

These businesses often work on a subcontract basis and are heavily dependent on upstream payments. Any disruption in the flow of funds puts these firms at immediate risk, given their limited cash reserves.

Mitigating insolvency risks

There are steps the industry can take to address these issues. Greater use of fluctuation clauses in contracts, improved forecasting and budgeting, coupled with an increased focus on internal controls, can provide earlier warning signs of financial difficulties.

However, these measures require a cultural shift across the sector, as well as cooperation from clients and stakeholders to prioritise financial stability over the relentless pursuit of cost-cutting.

For accountants advising construction clients, understanding these pressures is vital from an insolvency prevention standpoint. Many construction businesses operate with little room for error, and effective advice – on cash flow management, contract structuring, and risk mitigation – can make the difference between survival and insolvency.

By recognising the systemic challenges that underpin the sector's high insolvency rate, you can help your clients navigate this volatile industry and build resilience for the future.



If you'd like more information on helping your clients, **please get in touch**.



Will VAT push private schools into insolvency?

The introduction of VAT on private school fees from January 2025 is going to be a major shift for the independent education sector. For those accountants advising private schools, this change demands careful planning, as many institutions may lack the financial resilience to absorb or adapt to the new tax regime. With tight margins already an issue, the added burden of VAT could push some schools into insolvency without proactive measures.

As you know, private schools, though not conventional businesses, still need to operate with sound financial principles. Most are either charities or companies limited by guarantee, bound by strict financial obligations. The addition of VAT, coupled with the removal of charitable business rate relief from April 2025, creates an immediate financial gap that schools must address to remain viable.

The VAT challenge

Private schools will need to decide whether to pass on VAT costs to fee-payers or absorb them. Many may struggle to raise fees sufficiently without risking lower enrolment, especially in the current economic climate. Accountants should help schools model scenarios, balancing potential fee increases against reduced demand, and advise on managing cash flow to handle VAT payments effectively.

Schools are already grappling with rising operational costs, including salaries and energy bills. VAT exacerbates these pressures. Some schools may need to consider cost-cutting, staff reductions, or asset sales. As accountants, you can guide schools through operational restructuring or explore longer-term solutions like mergers.

Insolvency risks

Schools relying heavily on fee income and short-term borrowing are particularly vulnerable. A significant drop in enrolment or inability to manage VAT could lead to insolvency. Early intervention is critical. Therefore, you must monitor their financial health closely, looking for signs of distress and advising schools to seek professional support when needed.

Remember, insolvencies in the education sector are more complex than in businesses, particularly for schools with charitable status. You will need to guide your clients through restructuring options, whether by negotiating with creditors, restructuring debt, or exploring funding alternatives.

You have a key role in helping private schools stay above water. You may need to consider steps like scenario modelling, cost management, cash flow, and ensuring VAT compliance. Schools showing signs of financial distress should be encouraged to act early and discuss restructuring options with an insolvency practitioner before insolvency becomes inevitable.



If your client is worried about VAT, **please get in touch**. We can give you the advice you're looking for.

CAREFUL CONSIDERATION IS NEEDED BEFORE TAKING OUT ANY FORM OF FINANCE AND SPECIALIST ADVICE SHOULD BE SOUGHT. IF YOU HAVE ANY QUESTIONS, PLEASE CONTACT US.

Newman & Partners Insolvency
Lynwood House
373/375 Station Road
Harrow
Middlesex HA1 2AW

T: 020 8357 2727
F: 020 8357 2027

E: insolvency@newmanandpartners.co.uk
W: www.newmanandpartners.co.uk

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