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Should Tax Be King?

The Debate over Tax Priority in Insolvency

Irving Aw, Brendan Crowley, and José M. Garrido, with the contribution of Kika Alex-Okoh

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Prepared by Irving Aw, Brendan Crowley and José M. Garrido, with the contribution of Kika Alex-Okoh*

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ABSTRACT: Countries differ in their approaches to the treatment of tax claims in insolvency. Historically, most countries have granted priority to tax claims. In the late 20th century, however, some countries abolished or reduced tax priorities at the same time that sweeping insolvency reforms were introduced. Since then, the debate over whether tax claims should be afforded priority in insolvency has continued. This paper reviews the various legal techniques used to protect tax claims in a wide range of countries, the arguments in favor and against tax priorities, and advocates for an empirical approach to analyzing this complex problem.

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WORKING PAPERS

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Contents

Glossary

CAMA: Companies and Allied Matters Act (Nigeria)

GDP: Gross Domestic Product

GVAT: Goods and Value Added Tax (India)

HMRC: His Majesty's Revenue and Customs (UK)

IBC: Insolvency and Bankruptcy Code (India)

ILO: International Labor Organization

IMF: International Monetary Fund

IRS: Internal Revenue Service (USA)

ISORA: International Survey on Revenue Administration

OHADA: Organization for the Harmonization of Business Law (Africa)

PAYE: Pay As You Earn

RA: Revenue Administration

TADAT: Tax Administration Diagnostic Assessment Tool

UNCITRAL: United Nations Commission for International Trade Law

VAT: Value Added Tax

WB: World Bank

Executive Summary

The title of this paper, "Should Tax Be King?", refers to the longstanding debate over whether tax claims should reign supreme in insolvency proceedings. Historically, many jurisdictions have treated tax claims as "sovereign" - placing them above other creditors in priority rankings, reflecting the view that the state's interests should be paramount.[1] This royal treatment of tax claims stems from the medieval principle where the sovereign's (king's) claims took precedence over those of ordinary subjects. Today, the question remains whether this special status is justified in modern insolvency systems or whether tax claims should be treated more equally with other creditors. This paper examines the arguments for and against maintaining the "sovereign" status of tax claims in insolvency proceedings.

Taxes, as liabilities that enterprises and individuals need to satisfy, can come into conflict with other debts owed by taxpayers when assets are insufficient to meet all obligations. The law establishes rules, including priorities, to allocate losses among creditors in such situations. Legislators often use priorities to improve the position of certain claims, such as taxes, in the event of debtor insolvency. However, priorities have costs in terms of reduced recovery for other creditors and potentially reduced access to credit for debtors.

This paper analyzes the position of tax claims[2] in insolvency. The situation of insolvency is defined by the inability of the debtor's estate to satisfy all claims. Inevitably, this results in a conflict among creditors, and one of the crucial functions of insolvency law is to decide how the losses derived from the debtors' insolvency should be distributed among the creditors affected by it.

A variety of legal techniques are used to resolve conflicts among creditors, especially in insolvency. Historically, the proportionality or *pari passu* rule was used to distribute losses proportionally among claimants. However, preferential treatment soon emerged as an alternative to favor certain interests. Most systems use a combination of legal techniques for creditor protection, although some advanced economies have trended towards reducing priorities.

Priorities provide extra protection to some claims based on a right exercised against other creditors. General priorities offer a right to be paid before unsecured creditors. Special priorities provide a preferential right to be paid from proceeds of a specific asset. Secured credit also grants priority to claims but uses a different legal technique based on the bargain between debtor and creditor, and, ideally, reflected in registries accessible to other creditors. The preferential treatment of secured credit is based on economic efficiency considerations and secured credit is generally preferred to statutory priorities. Exceptionally, some legal systems have placed certain "super-priorities" above secured credit. Statutory security interests or liens use the legal technique of secured credit without requiring debtor consent. Some jurisdictions offer more intense protection by extending priority status to these statutory security interests. Alternative credit protection techniques based on possession or ownership of assets are also used in certain legal systems. In the absence of priorities or alternative protection mechanisms, claims are treated as ordinary and share proportionally in remaining proceeds after preferred claims are satisfied. Some legal systems also recognize subordinated claims that rank below ordinary ones.

[1] See Shanker, 1976.

[2] The paper focuses on tax claims, including payments related to taxes such as interest and penalties. Social security claims raise similar issues and are often treated in the same way as taxes for the purposes of priority, but this is not always the case and the analysis of social security claims is outside the scope of this paper.

Countries deploy various legal techniques to protect tax claims. General priorities are most frequently used, placing taxes ahead of unsecured claims in the ranking. Some limit the time period or amount covered by the priority. Super-priorities provide the highest protection, with taxes paid ahead of all other claims, while special priorities give preferential rights over specific assets. Security interests of several types can also benefit taxes. Alternative techniques like deemed trusts or rights of possession are sometimes used.
In some countries, tax claims have been reclassified as ordinary or even subordinated claims. Treatment of accessories like interest and penalties also varies. It is important to note that tax authorities benefit, in most legal systems, from the possibility of registering unpaid taxes so as to gain the status of secured claims over the assets owned by tax debtors. In some countries, there is a trend to require transparency of tax debts over a certain amount to make third parties aware of the potential impact of tax priorities.

There is wide disparity across countries in the approach to tax priorities. This paper includes the widest comparative legal analysis to date, comprising 60 countries that represent more than 91 percent of global GDP and more than 84 percent of the global population. The selected countries are representative of all regions, legal traditions, and income levels. Most countries recognize a general priority for taxes, while several countries, mostly advanced economies, have curtailed or removed such preferential status in recent years. The diversity of approaches highlights that the debate over tax priorities remains unresolved.

The question of whether tax authorities should be treated more favorably in insolvency cases than other creditors is one that policymakers and commentators globally have failed to agree on. Insolvency reforms affect a wide range of stakeholders and often must address intense conflicts among diverging interests. The issue of tax priorities is one of the most contentious and our analysis shows that countries have also adopted a variety of diverse approaches in legislation.

The question has been hotly debated with a vast range of arguments put forward both for and against the existence of tax priorities. Many arguments about the validity or otherwise of tax priorities express a policy or political position or are based on value judgments. In general, priorities seek to minimize the exposure of certain interests to the impact of insolvency by providing a higher ranking to certain claims based on some perceived societal value or economic rationale. The tax authority (and indirectly, the taxpayers) are either given some form of greater protection from the damage of insolvency than unsecured creditors or they are put on the same footing as those unsecured creditors. Other arguments are based on the analysis of the law, on logic or on logical assumptions about the operation of the insolvency regime or the behavior of creditors and the tax authorities. This paper collects and develops all the arguments in favor of or against tax priorities, with the goal of having an informed discussion of this complex issue.

Arguments in favor of tax priorities include the following: tax priorities serve the essential public interest in financing government functions, maximize tax collections, represent a fair allocation of costs to those benefiting from the debtor's economic activity, avoid unfairly benefiting powerful private creditors at the expense of taxpayers, recognize the state's status as an involuntary creditor, compensate the state for maintaining the insolvency system, signal the social importance of tax compliance, and deter both tax defaults and evasion through bankruptcy.

The list of arguments against tax priorities is as follows: those opposing tax priorities assert that the state is the most powerful, wealthy, and diversified creditor, has vast resources and legal tools to enforce tax claims, and does not need or deserve any additional protections, particularly against vulnerable private creditors. Tax priorities undermine the fundamental ranking of claims, encourage inefficiency in monitoring and collection of tax claims, negatively affect other creditors, and are inconsistent with other fiscal policy goals during crises.

Beyond policy considerations, some of the arguments put forward about tax priorities consider their impact on the behavior of various actors including the tax authority, the debtor, other creditors, or society at large. However, some of these arguments make assumptions as to the actual behavioral impact of priorities without providing empirical evidence to validate these assumptions. This paper considers what evidence would be required to validate (or invalidate) each of these arguments. The collection of this data could provide guidance as to the type of empirical evidence that could be extremely helpful in reaching a wider consensus as to the effects of tax priorities.

A key consideration is whether tax priorities are effective as a means of recovering taxes. Tax priority does not guarantee the recovery of the amounts owed by the debtor - it only ensures that the tax claims will be paid before the claims of other creditors provided there are enough resources in the insolvency estate. If the debtor is deeply insolvent, even the tax claims will be unpaid. Again, there is a lack of concrete evidence as to whether the existence of priorities significantly increases the amount of tax recovered.

The strongest argument against tax priorities is that the priorities damage private parties more than they benefit the tax authorities. To assess the validity of this argument, it would be necessary to measure the income that tax authorities receive through their participation in insolvency proceedings and compare those payments with what the tax authorities would have received in the absence of priorities. At the same time, it would be important to calculate the increase in payments to unsecured or lower priority creditors if the tax claims would not have a priority.

The lack of available evidence does not allow a conclusion to the debate. This paper organizes all the arguments used in the debate and seeks to draw attention to the fundamental challenge posed by the insufficiency of data. The paper considers limited available data which puts the debate on tax priority in perspective and lends support to the observation that despite the intensity of the arguments, the debate may not be so relevant from the perspective of the public interest given the relatively small amounts of total tax receipts (as compared to total revenue collection) that are likely to be impacted by tax priorities. Countries that have abolished tax priorities have not experienced public finance problems that can be attributed to the elimination of priorities, possibly because of the lack of overall economic significance of the priorities for the state. However, those amounts may be significant for private creditors.

Tax authorities and insolvency policy makers should be aware of the importance of collecting data to formulate adequate legislative rules. The debate on tax priorities, as many other policy debates, can ultimately make progress through the collection of data as to the actual impact of tax priorities within the overall context of insolvency proceedings.

I. Introduction

Taxes do not exist in a vacuum: they can collide with other debts owed by taxpayers. Tax policy comprises a comprehensive set of direct and indirect taxes affecting economic activities. From the perspective of enterprises and individuals, taxes are liabilities that need to be satisfied. However, enterprises and individuals may also incur other liabilities, and when their assets are insufficient to meet all their debts, the law needs to establish rules for the allocation of losses among creditors. This is where priorities come into play.

Legislators often use priorities for different purposes. Legislators tend to regard priorities as useful legal techniques to improve the position of certain claims, especially in the event of the insolvency of the debtor. However, priorities have costs – the costs are represented by the impact on third parties (other creditors) whose possibilities of recovery are reduced. Indirectly, this may also reduce the debtors' access to credit.

There is wide disparity over the approach to tax priorities. A majority of countries generally recognize a priority treatment to taxes. However, while it is not uncommon for tax or insolvency legislation to accord some degree of priority to tax debts as a means of improving their recovery possibilities in the event of the insolvency of debtors, a number of jurisdictions have curtailed or altogether removed such statutory preferential status for tax debts in recent years (see Annex III).[3] As figure 2 shows, in the sample of sixty countries selected for the analysis in this working paper, there are 41 countries where taxes generally enjoy priorities, and 19 where those priorities either do not exist or are considerably limited (see Annex I for more detailed information).

The issue of tax priorities in insolvency is controversial. This paper reviews the arguments that are used both by those who defend and those who attack the existence of tax priorities. The paper seeks to be as comprehensive as possible, including all possible arguments leveled against the existence of tax priorities in insolvency and all arguments used to defend tax priorities. Ultimately, the solution to the issue depends on policy choices made by legislators: this paper aims at advancing the discussion by taking stock of all the arguments and indicating the sources of data that would be necessary to validate those arguments, while lamenting the scarcity of such data. Unfortunately, it is often the case that the abrasiveness of arguments tends to be correlated to the absence of relevant data. It is also worth considering the consequences of the policy choices implied in designing priorities for tax claims, or in altogether abandoning the priority treatment of tax claims.

[3]See Wood, 2011 and 2013. See McCormack et al. 2017, for an overview of the trends in regulation of priorities in European countries.

II. Legal Techniques for the Treatment of Tax Claims in Insolvency

A) The system for the treatment of claims

Legal rules resolve conflicts among creditors, particularly in insolvency. When a debtor has sufficient assets to pay off its creditors, conflicts among claimants are minimized. Ultimately, all claimants receive payment in full. However, faced with the insufficiency of assets to satisfy all claims which defines insolvency, the law needs to provide solutions for the conflict among the holders of the various claims.

This paper focuses on legal rules to resolve conflicts among claims, as applied to tax claims in the context of insolvency proceedings. It is important to note that priorities also apply outside of insolvency cases: in enforcement proceedings against a debtor, there may be a conflict between different creditors, and in those cases, priorities are also used. Of course, the priorities become more significant when the debtor is insolvent and there are not enough assets in the estate to repay all claims in full. In any case, a fundamental principle of insolvency law is that the priorities existing outside insolvency must be respected in insolvency:[4] differences in the treatment of claims outside insolvency and in insolvency could potentially generate perverse incentives among creditors who would benefit from those differences. Insolvency law must generally recognize the priorities set in non-insolvency law: otherwise, parties would maneuver into insolvency to benefit from changes in the treatment of their claims.[5] .

In the early stages of insolvency law, the proportionality rule resolved most conflicts among creditors. When commercial insolvency laws were first invented in the Italian city states of the Middle Ages, the general rule to solve the conflict of creditors over the insufficient estate of debtors was the proportionality rule, also known as the "*pari passu*" rule. This rule has been often described as enshrining "equality" among creditors. In practice, however, rather than equal treatment, the rule prescribes a proportional distribution of the loss among claimants, so that all creditors suffer the damage in proportion to the full amount of their claims (e.g., if the debtor has assets for a value of 3 million florins, and there are claims for a total of 10 million florins, every creditor will receive a payment for thirty percent of their total claims). The exact amount that creditors may receive can vary widely since that depends on the original amount owed to them[6].

However, preferential treatment emerged soon as an alternative way of resolving conflicts among claimants. The main alternative to the proportional treatment of claims is to provide a priority to a particular claim. This means that the specified claim will have to be satisfied in full before other creditors can receive a payment. Insolvency law soon established exceptions to the proportionality rule to favor certain interests, such as dowries and taxes.[7] The recognition of a priority in favor of certain claims alters the way proceeds are distributed among creditors.

[4] See Jackson, 1986, ch.2, "Determinining Liabilities and the Basic Role of Nonbankruptcy Law",

[5] On this point, see also Jackson and Scott, 1989; Adler, 1992.

[6]This means that a creditor holding a 1 million florins claim would receive 300,000 florins, and a creditor with a 100,000 florins claim would receive 30,000 florins. This is a proportionality-based system. A system based on equality would establish equal payments for all creditors.

[7] See Garrido, 2000, 216 ff.

Priorities seek to provide extra protection to some claims. Proportional treatment may not be the right solution when it is considered that certain claims are linked to interests that deserve more intense protection than ordinary claims. For this reason, statutory priorities have been introduced whenever legislators assign a higher value to certain claims: this explains the existence of priorities for workers' claims, for certain contractual and tort claims, and also, for tax and social security claims. In every case, there is a value judgment that translates into priorities that fit within the general ranking of creditors. When changes are made to priorities, the motivations for change are usually made clear by policymakers. However, many priorities are long-standing in legislation and the purpose for maintaining the priorities is not always apparent.

Priorities are based on a right that is exercised vis-à-vis other creditors of the same debtor. Priorities arise by operation of law, as they are based on a right that is granted to the creditor directly by a statute. The creditor who holds the priority claim is entitled to recover from the proceeds of the sale of the debtor's assets (just like any other creditor) but also has the right to be preferred in payment to other creditors of the same debtor. This is the right that the law attributes to the holder of the preferred claim, and this right is exercised vis-à-vis other creditors. In some cases, the right to receive a preferred payment is exercised vis-à-vis unsecured creditors. However, priorities can also be in distinct positions of the ranking of claims, so that a priority gives the right to receive a payment over the unsecured creditors *and over any other priority creditors who are placed in a lower position in the ranking*.[8] From the point of view of legal analysis, therefore, a priority is a personal right that the holder of a claim has against other creditors, as established by the ranking of claims.

Special priorities are those that provide the creditor with a preferential right to be paid from the proceeds of a specific asset. Most of the features described above also apply to special priorities. Special priorities are created by the law and provide the holder of the claim with a right to be paid before other creditors. The peculiarity of special priorities is that the priority is limited to the proceeds of the sale of a specific asset or assets. In this way, it is possible to distinguish between general priorities and special priorities. This distinction is codified in numerous civil law systems (e.g., France, Italy, and Spain). Typically, the priority limited to an asset is based on the connection that exists between that asset and the creditor's claim. For instance, a landlord may have a priority over the assets of the renter that are located in the property, to cover the amount of unpaid rent.[9] Some of these priorities require that the creditor remains in possession of the asset (special possessory priorities), but this is by no means a requirement for all special priorities.

Special priorities are limited to the proceeds of an asset or group of assets. When the proceeds from the sale of the assets object of the special priority are sufficient to satisfy the claim, the rest of the funds will be distributed according to the other provisions in the statutory hierarchy of claims. However, if the proceeds from the sale of the assets object of the special priority are not sufficient to satisfy the claim, the unsatisfied portion of the claim becomes an unsecured claim, subject to the proportionality rule.

Secured credit also grants a priority to claims, but it has a different rationale and uses a different legal technique. Security also has the effect of creating a priority that favors a claim, but its rationale is completely different from that of priorities. While priorities are established directly by the law in order to protect interests

[8]In some legal systems, such as in English law, priority claims are all placed in the same category, so that the proportionality rule applies among them in the case where there are insufficient funds to pay all preferential claims. In most legal systems, however, preferential claims are ranked internally, so that a lower priority claim cannot receive a payment until the higher priority is paid in full.
[9]See for instance art. 2332 of the French Civil Code or art. 2764 of the Italian Civil Code.

that are worthy of special treatment, secured transactions law creates a framework that relies on the free bargaining by the debtor and its creditor. The agreement between the debtor and the creditor results in the recognition of a priority in favor of the creditor. The creditor holding the security interest is entitled to receive a payment with the proceeds of the sale of the encumbered asset. Technically, security interests are different from priorities since they provide the creditor with an *in rem* right. Differently to the right in general and special priorities, the right of priority granted by a security interest can be exercised not only against the creditors of the person who created the security interest, but also against third parties, under certain conditions. This provides the secured creditor with additional protection. In order to balance the interests of the creditor and the interests of third parties, it is normally required that security interests be registered, so that their existence can be ascertained by the public.[10] Registration also provides the basis for the ranking of security interests: a security interest registered before has priority over a security interest registered subsequently.

The preferential treatment of secured credit is based on reasons of economic efficiency. In all legal systems, secured credit enjoys a priority over unsecured credit to the extent that the secured creditor's claim is covered by the collateral. This is based on the general assumption that the bargain between the debtor and the secured creditor providing a priority over the collateral must be respected because it has beneficial economic effects for all parties. Although there is some discrepancy among theorists, the consensus is that secured credit increases access to credit by reducing the secured creditor's risk, and increased access to credit has positive effects for the debtor, other parties, and society as a whole.

Secured credit is generally preferred to statutory priorities. The relationship between secured credit and priorities is generally based on the recognition of a superior treatment for secured credit. This probably relies on the argument that secured credit promotes economic efficiency. However, there have been examples of national legal systems that have placed certain priorities above secured credit. These priorities are known as "super-priorities" or "super-privileges." Because these super-priorities reduce the availability of secured credit, they tend to afford protection to small claims, limiting their negative impact. For these reasons, the best example of super-priorities refers to the claims for salaries. In most cases, the super-priority is limited to the portion of the wage claim necessary for the worker's maintenance (for instance, a super-priority covering workers' salaries for the last four months before commencement of insolvency).[11]

An additional possibility of providing protection to claims is based on the use of the legal technique of secured credit, but without the requirement of a bargain between debtor and creditor. As indicated before, secured credit provides priority to the creditor based on an agreement reached between the debtor and the creditor. In essence, the bargain includes the granting of credit in exchange for receiving a priority over collateral to ensure repayment. However, the laws have used the technique of the security interest to provide protection to special interests. This is called a "statutory security interest" or "statutory lien"[12], which highlights the fact that the security interest is created without the need of the consent of the debtor. The statutory security interest can be registered by the creditor, thereby achieving the same protection as an ordinary security

[10]This is the model for the mortgage and for modern security interests over movable assets. There is another security interest -the possessory pledge- that is not based on registration (however, dispossession of the asset in the pledge serves the double function of protecting the creditor and also avoiding that third parties rely on the debtor holding the asset).

[11]Some examples of super-priorities include the treatment of salaries in Malaysia, Mexico, and Peru. See ILO, 1991.

[12]For instance, in the legal systems of Austria and Germany, general priorities have been abolished, but the category of "statutory pledge" still exists and benefits claims connected to a specific asset. In Belgium, a "statutory mortgage" for tax claims can be registered by the tax authority to protect tax claims.

interest.[13] In other cases, the legal system offers the possibility to creditors enforcing a claim of requesting a court order to register a security interest in their favor, to protect the successful enforcement of the claim (this is known as a "judicial lien" or "judicial security interest").

Some legal systems offer a more intense protection by extending a priority status to statutory security interests. In some legal systems, there is a further twist to the technique that allows the creation of a security interest over real estate, without the consent of the debtor, consisting in exempting this security interest from the registration requirement and placing this statutory security interest over all registered security interests, irrespective of whether security interests have been registered before or after the moment the especially protected claim originated. In some legal systems this technique is known as a "privileged security interest" or as a "real estate privilege"[14], since this protection technique typically refers to real estate assets.

Some jurisdictions may offer alternative techniques for the protection of certain credits, based on specific features of their legal system. While the protection techniques outlined above apply to all legal systems, there are certain specific tools for credit protection that are only available in certain legal systems. For instance, under certain legal regimes, it is possible to allow creditors who are in possession of debtor's assets to retain those assets until the claims are repaid. In most legal systems, those rights to retain possession of assets are ineffective in the event of the insolvency of the debtor, but there are some legal systems (notably France and some countries influenced by French civil law) where this right to retain possession can be asserted in insolvency, which provides an intense protection for the creditor. In common law systems, there is a possibility of using trusts as a means of protecting claims. The doctrine of constructive trusts allows the separation of assets for the repayment of certain claims. The law itself can establish trusts (statutory trusts) by which some assets are separated from the debtor's estate and can only be used for the repayment of the claims benefitted by the trust. The common feature of these legal techniques is that they use characteristics of property law (right of possession, separation of ownership) with the effect that the holder of the claims receives protection.

In the absence of priorities, security interests, or alternative protection techniques, claims are ordinary. The category of ordinary claims is often confused with that of "unsecured" claims.[15] Within the category of ordinary claims, the proportionality rule fully applies. As nothing distinguishes ordinary claims from each other, there is no basis for some claims to be preferred over others. Because of their same legal strength, unsecured claims need to share proportionally the proceeds of the debtor's assets once preferred claims have been satisfied.

There can be categories of claims below the ordinary claims. The status below ordinary is normally identified with the term "subordinated." Subordination of claims can arise by contract: i.e., a creditor agrees to receive payments only after unsecured claims have been fully paid. In some legal systems, subordination can also be the result of the application of statutory rules or equitable principles. In essence, a claim can be subordinated because, as a matter of legal policy, it is understood to be less deserving of protection than unsecured claims. In this regard, subordination of claims works as an "anti-priority."

[13]This implies that, in the absence of special rules, the ranking of these statutory security interests is done in accordance with the general criterion of priority in time ("*first in time, first in right*") referring to the time the security interests are registered. Registration of statutory security interests is done by the creditor, without requiring the debtor's consent or cooperation.

[14]See art. 2734 of the French Civil Code; art. 2103 of the Spanish Civil Code; and art. 2825 bis of the Italian Civil Code.

[15]In fact, as this overview shows, there are multiple categories of creditors beyond "secured" and "unsecured." Probably it is useful to consider at least a third category, that of preferential creditors.

Legal systems across the world use diverse combinations of legal techniques for the treatment of claims. Most systems combine proportionality treatment for unsecured claims and the existence of priorities, in various measures. Legal systems evolved by adding priorities and new types of security interests. These developments reflected the need to protect diverse interests and the improvements in legal techniques that allowed the creation of security interests over new types of collateral. Tax claims may benefit from a diverse array of priority techniques (see figure 1).

Recent reforms in some advanced economies have started a trend of reducing priorities. Australia, Austria, Denmark, England, Germany, and Spain are among the countries that have reduced priorities, with the overall goal of increasing the protection for ordinary creditors. In some cases, protection for ordinary creditors has also increased by the expansion of the category of subordinated creditors (Germany and Spain) or by limiting the scope of the priority of security interests (England). However, many other legal systems, in both advanced and emerging economies, maintain complex rankings of claims that make use of various techniques to provide different degrees of protection to numerous claims.

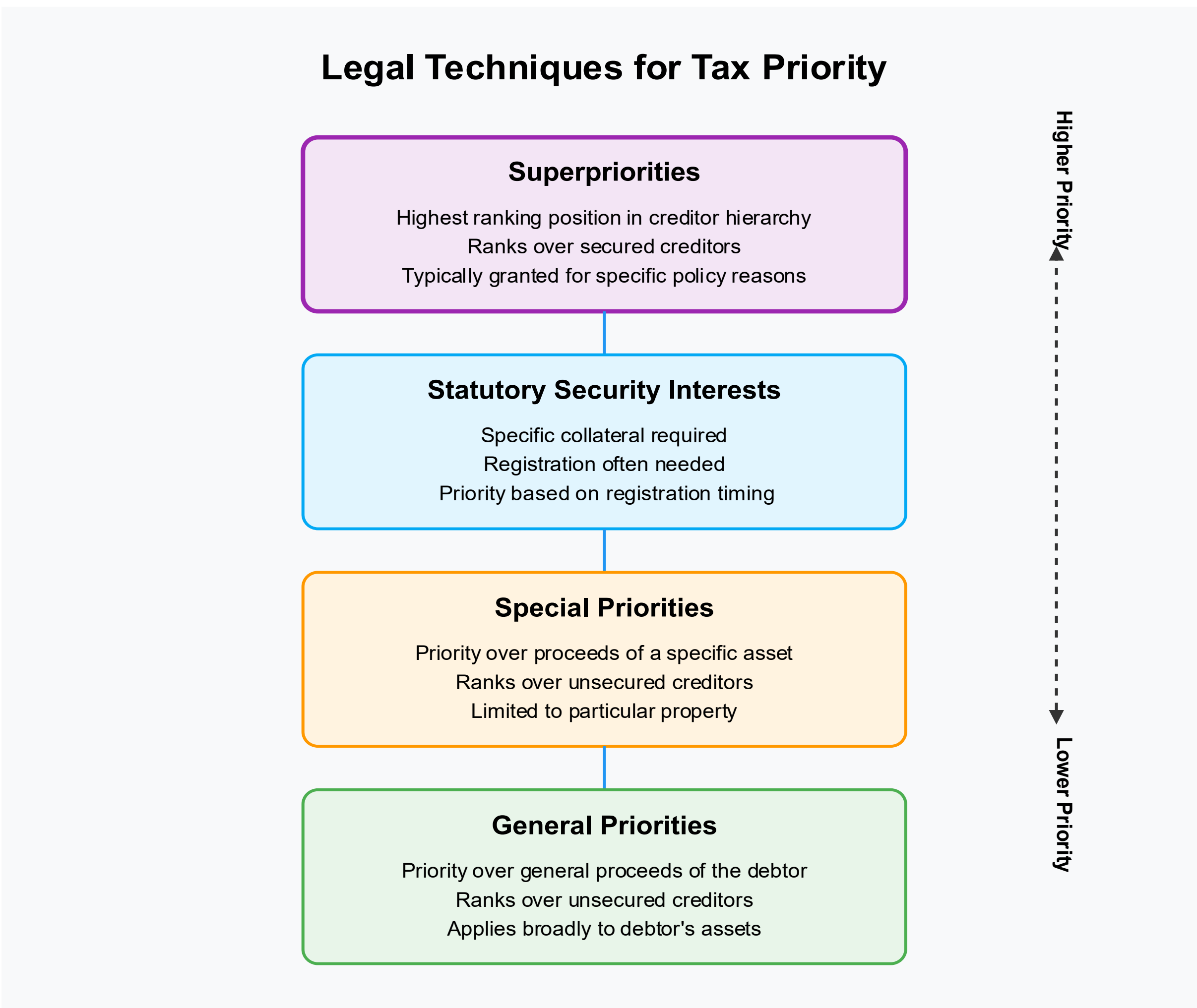

Figure 1: Legal Techniques for Tax Priority

B) Tax claims in credit protection regimes

Taxes are claims owed by debtors to the state (including any public administration). These claims originate in public law – the statutes establishing taxes – and are created irrespective of the consent of the debtor. Taxes are sources of public revenue and are essential for the provision of public services and the maintenance of the state. Taxes, therefore, need to be protected by enforcement measures when debtors do not voluntarily comply with payment of their tax debts. Enforcement is a central part of the legal regime for taxes: in many countries, tax authorities benefit from a special enforcement regime that includes self-help measures and administrative procedures that allows them to act against debtors without resorting to judicial proceedings. This can include seizure of assets, bank accounts or salaries.[16] Despite the existence of this special procedural regime, where applicable, conflicts between tax claims and other claims occur, and these conflicts are most intense in the case of the insolvency of the debtor.

Tax claims may benefit from the protection provided by various legal techniques. This paper focuses on the debate on whether tax claims should benefit from preferential treatment or should be treated as ordinary claims. This requires analyzing how, in various legal systems and historical periods, tax claims have enjoyed – or still enjoy – special protection through many of the techniques that have been described above.

a) ***General priorities*** **are the most frequently used technique to protect tax claims.** Tax claims enjoy general priorities in numerous legal systems (Figure 2 shows that 41 countries of the 60 countries in our sample recognize general priorities in favor of tax claims). This priority may benefit all taxes. The effect of the priority is to place tax claims before unsecured claims in the ranking of claims. Depending on the legal system, this may imply that tax claims are placed together with other preferential claims in the same class, or that tax claims are included in a certain position within the ranking of preferential claims (for instance, there are numerous legal systems where tax priorities are ranked below the priorities of workers' claims)[17].

[16] These represent a different type of special treatment – i.e., "procedural privileges," which may take different forms. Procedural privileges are outside of the scope of this paper.

[17] This is the case, for instance, in the systems of Argentina, Brazil, Cambodia, Cameroon, China, Colombia, DRC, Egypt, France, Haiti, Honduras, Indonesia, Israel, Italy, Malaysia, Netherlands, Nicaragua, Norway, Philippines, Poland, Rwanda, Singapore, South Africa, Spain, Tajikistan, Türkiye, UAE, USA and Venezuela.

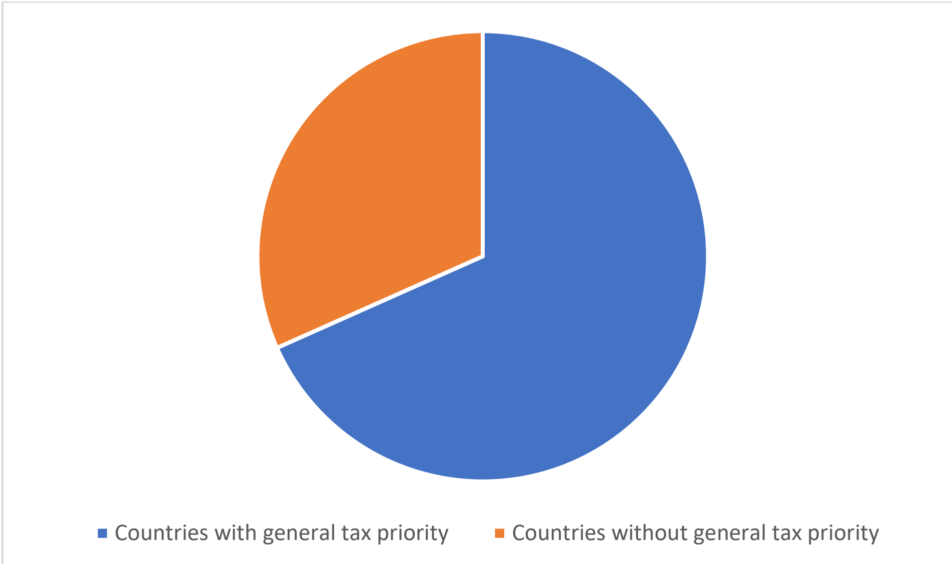

Figure 2: Countries with and without general tax priority

Because of the increase in the number and amount of tax claims, some legal systems have placed limits on the tax claims that enjoy a general priority. Limits can work in two diverse ways: a temporal limit establishes the number of fiscal years for which tax claims enjoy a priority (for instance, tax claims for the last fiscal year, counting from the commencement of insolvency, as in the case of Pakistan or Tanzania).[18] A limit on the amount of taxes that enjoy the general priority can be established by determining a maximum amount or a percentage of the total tax claims that enjoy the general priority (for instance, fifty percent of the tax claims, in the case of Spain) or a maximum percentage of proceeds (for instance, in Argentina general tax priorities cannot absorb more than fifty percent of the proceeds, after payment of secured creditors and special priorities). In our sample, among countries that have general priorities, 23 countries do not impose any limits, whereas 17 countries have set time limits, and 2 countries set amount limits (see figure 3 for a breakdown of limits to general priorities in our country sample).

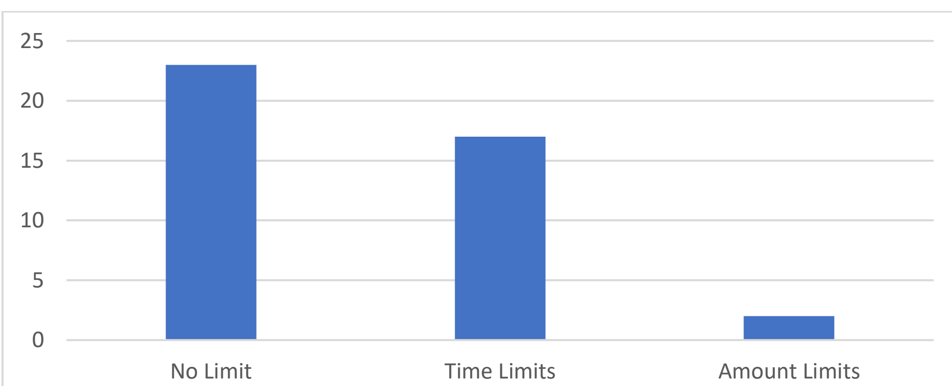

Figure 3: Unlimited general priority and limits applied.

[18]Countries that establish time limits to general priorities of tax claims include Egypt, Ghana, India, Indonesia, Ireland, Israel, Japan, Nicaragua, Nigeria, Norway, Pakistan, Papua New Guinea, Sri Lanka, Tanzania, Thailand, and the USA.

b) ***Superpriorities*** **offer the highest level of protection to tax claims.** With a superpriority, tax claims have preference to be repaid out of all the assets in the debtor's estate, prevailing over all unsecured, preferential, and secured claims. Because of the interference with secured credit, some jurisdictions? that recognize superpriorities limit them to taxes that are especially connected to an asset.[19] In such cases, the distinction between a superpriority and a preferential statutory lien becomes blurred.

c) ***Special priorities*** **can also be deployed in support of tax claims.** The special priority, which is limited to the proceeds of a specific asset or assets, requires a certain connection between the claim and the assets. This tends to be the case with certain taxes, such as sale taxes, real estate taxes or excise taxes. In other countries, indirect taxes benefit only of general tax priorities, where these exist. There is wide variety in the approaches implemented by jurisdictions: in our sample, only 7 countries have special priorities for taxes, whereas 34 countries rely on general priorities and 19 have no priorities (see figure 4 showing the use of special tax priorities among selected countries).

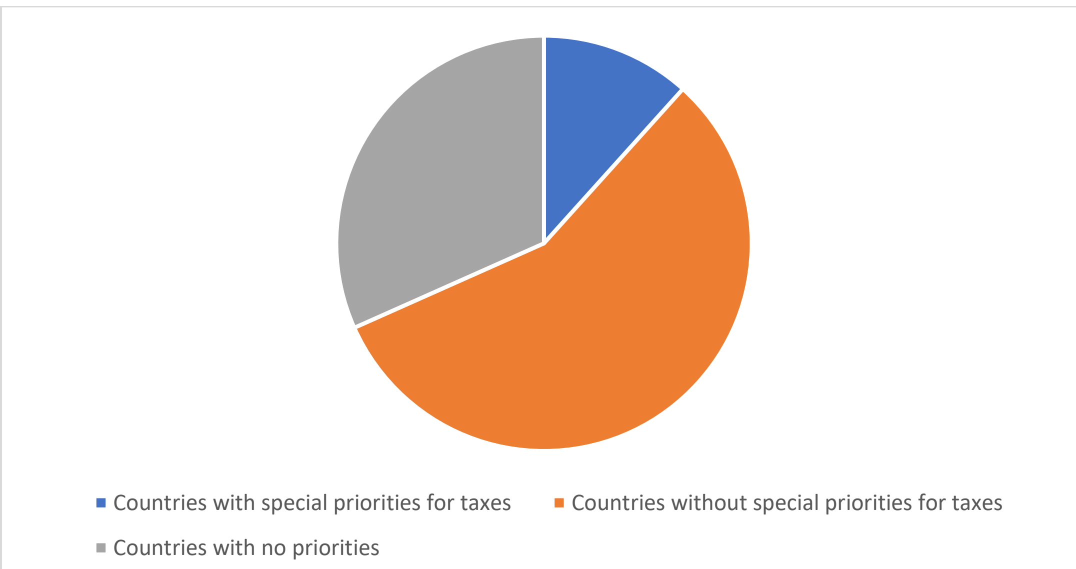

Figure 4. Use of special priorities to protect tax claims.

d) ***Security interests*** **of several types can also benefit tax claims**. In most countries, the tax administration can request the debtor to provide a security interest to protect unpaid taxes. In some countries, the tax administration does not even require any positive action by the debtor and can directly register a security interest over the debtor's assets (*statutory lien* or *statutory security interest*). These security interests provide the same protection as a negotiated security interest and are ranked according to the time of registration. This technique seems to be generally available in all jurisdictions. *Preferential statutory liens* are similar to statutory liens, but they do not

[19]See, for instance, the Republic of Korea, where taxes assessed on and arising directly from the collateral, such as an inheritance tax or a donation tax, precede secured claims regardless of the date of its assessment (Oh and Song, 2008). See also the superiority for real estate taxes in Israel (section 11(A)1 of the Tax Ordinance Collection.

need to be registered to be effective and are preferred to security interests over the same asset, even those registered before the preferential statutory lien came into existence. A preferential statutory lien, therefore, works as a super-priority.[20]

e) **Taxes can also be protected through the use of *alternative credit protection techniques*.** There is a wide variety of alternative techniques among legal systems, but generally they rely on mechanisms connected with the possession or ownership of assets. In some common law systems, taxes are protected by *deemed trusts:* where a person acts as an agent of the tax administration in collecting certain taxes, such as VAT and withholding tax on the income of employees and non-residents, it is considered that the collected amounts belong to the tax administration and are held on trust by the entrepreneur. The tax authority becomes the beneficial owner of the amounts held on trust.[21] In other legal systems, tax authorities can benefit from the extraordinary effect of the right to retain possession of assets. Assets connected to taxes (for instance, excise taxes and customs duties) can be retained by tax administration staff, and not returned until the connected tax claims have been paid in full.

f) **Tax claims as *ordinary claims*.** In some legal systems, in the past few decades, tax claims have been classified as ordinary claims, fully (as in Australia, Austria, Germany, New Zealand, or the UK) or in part (as in Spain). This mainly implies the elimination of general priorities. If other techniques for credit protection are included in the analysis, it seems that there are still examples of tax claims that can benefit from certain priorities or alternative techniques, even in systems where tax priorities are supposedly abolished (for instance, there are techniques that protect certain taxes in Austria or Germany)[22]. There are also non-priority techniques that increase the probabilities of recovery of tax claims, for instance by establishing the liability of additional persons (typically, directors of a company).[23]

g) **Tax claims as *subordinated claims*.** There is also the possibility that tax claims become subordinated to ordinary claims. When claims are subordinated, the legislator is assessing that those claims deserve less protection than ordinary claims. This is seldom the case for tax claims, as they protect public interests (but there are cases of subordination of tax claims, such as in the Kyrgyz Republic). However, there may be certain accessories of tax claims such as penalty interests, and tax penalties, which need to be considered differently in the context of insolvency. These are disincentives to push debtors to comply with their tax debts, but they become ineffective in the case of insolvency, where debtors have no longer control over their finances and the consequences of late or missed tax payments would be suffered by the other creditors. For this

[20]A specific practice is that of China, where the tax authorities do not register tax claims, but assert their priority for unpaid taxes over secured claims registered after the tax were due and unpaid.

[21]This construction is used only in some common law jurisdictions (Canada is the best example). In theory, the deemed trust would offer absolute protection to tax claims, but in practice there are frequent conflicts with secured creditors: see Crawford, 2018.

[22]In Austrian or German law, there are “legal pledges’ (*Gesetzliche Pfandrechte*). This term refers to a special priority, similar to a pledge over certain assets, and may benefit indirect taxes that refer to specific assets of the debtor.

[23] This is an important mechanism to increase the probabilities of recovery, and even more so in legal systems in which tax claims do not enjoy a general priority, like in Australia: See Villios, 2016a and 2016b). In Australian tax law, there is a personal liability of directors for non-remitted taxes that were withheld from payments to third parties (director penalty notices), and there is a debate on whether this liability should also extend to unpaid income taxes (see Krever, 2023).

reason, some legal systems subordinate tax penalties (e.g., Belgium, Brazil, Israel, Poland, Russia, Spain, and Sweden) and penalty interest (e.g., Jordan, Kyrgyz Republic). In our country sample - see figure 5-, numerous countries (21) do not have a special provision dealing with the treatment of fines and interest, whereas 18 countries include fines and interest in the priority, 6 countries subordinate fines and interest, and 3 countries expressly exclude fines and interest from any priorities).[24]

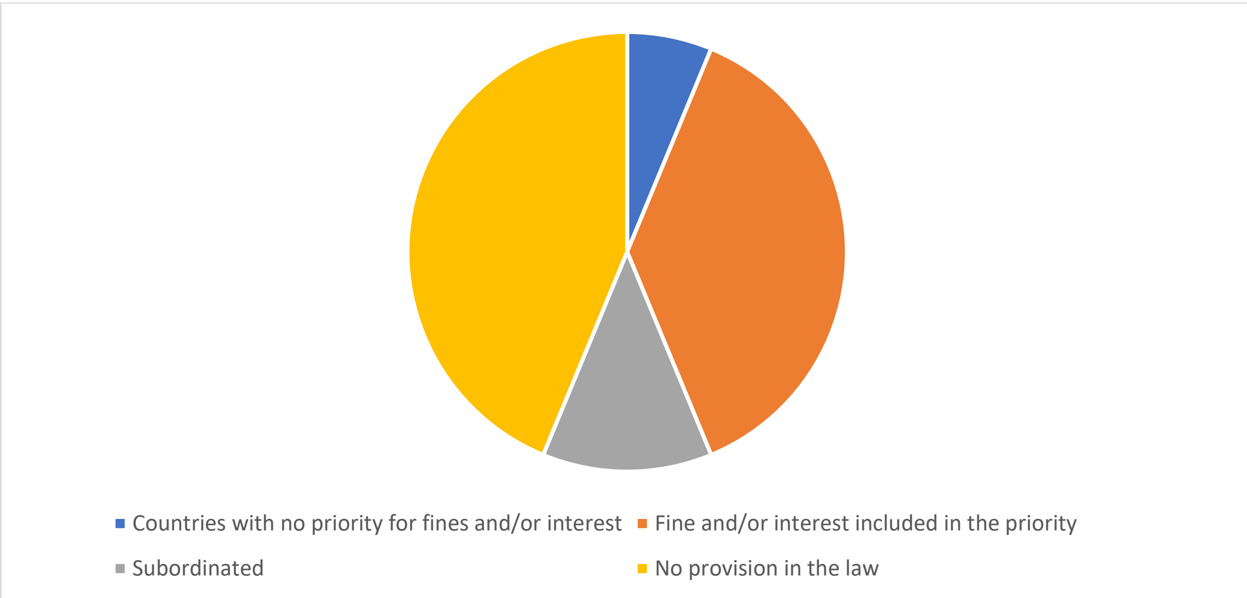

Figure 5. Fines and interest and tax priority.

This overview shows that many countries deploy various legal techniques for the protection of tax claims, whereas some countries have reduced the level of protection of tax claims. A particular trend is that the treatment of certain taxes, particularly those taxes for which the debtor act as a withholding agent (e.g., VAT or workers' income taxes) tends to be especially protected, even in some systems that have otherwise abolished general priorities for tax claims (see figure 6, showing that there are 24 countries in our sample that make specific provisions for these taxes, whereas the rest do not include any special provisions for these taxes, which follow the general treatment of other tax claims).

[24]Alternatively, some systems may provide a general priority for tax claims, but place penalty interest and tax penalties in a lower level, such as that of unsecured claims.

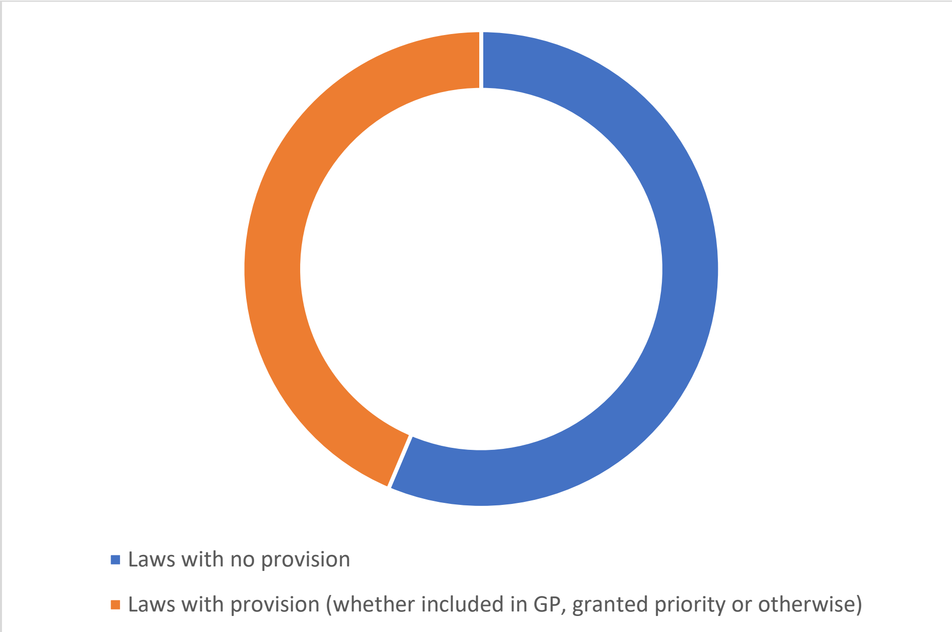

Figure 6. Special provisions for VAT and withholding taxes.

III. The Debate on tax priorities

Tax priorities have become a tug of war, especially in countries where insolvency reforms are being discussed. Insolvency reforms tend to be controversial because insolvency conflicts affect all classes of interests: the public interest (such as taxes, social security, and environmental protection); the interests of workers; of suppliers, landlords, or of financial institutions; and the interests of the entrepreneurs or individuals as debtors. Insolvency, therefore, has the potential of pitting together all possible interests in a situation in which there are insufficient resources to satisfy all claims. By definition, insolvency proceedings distribute the *damage* among all the different stakeholders.

A range of arguments and counterarguments for the existence, modification or abolition of tax priorities have been put forward by commentators. This section summarizes these arguments and seeks to classify them between those that express broad policy positions and those that make assumptions as to the actual impact of tax priorities on the behavior of various actors or on the outcome of insolvency proceedings.

The absence of comprehensive data and statistics on a range of insolvency and tax issues is the main obstacle for the resolution of this debate. In particular, it is difficult to find statistics on the average recovery rates in insolvency for different classes of creditors, and most tax authorities do not publish information on the recoveries made through insolvency. Many of the arguments on the merits or otherwise of tax priorities rely on assumptions which could be rigorously evaluated should sufficient data be collected and considered. The lack of data is somewhat surprising, given the intensity of the arguments for and against the existence of tax priorities.[25]

Many arguments about the validity or otherwise of tax priorities express a policy or political position. Priorities seek to protect certain interests from the severe impact of insolvency, or at least to minimize the damage to those interests. Therefore, the ranking of claims and the relative order of priorities expresses the hierarchy of values that a country upholds in resolving conflicts between creditors. The fundamental question under consideration is whether tax claims deserve a special position in that ranking. This implies considering how to distribute the losses in insolvency and the special position of the state.

Beyond policy considerations, there are also arguments put forward about the impact of tax priorities on the behavior of various actors including the tax administration, the debtor, other creditors, or society at large. Although these arguments tend to be framed in logic, they typically make assumptions as to the actual behavioral impact of priorities without providing empirical evidence to validate these assumptions. In discussing these arguments, it is useful to consider what evidence would be required to validate (or invalidate) each of these arguments. This could provide guidance as to the type of empirical evidence that would be helpful in reaching a wider consensus as to the benefits or otherwise of tax priorities. In any event, there is a wide variety of arguments and also in the strength of each of these arguments.

A) Arguments in favor of tax priorities

At its simplest, deciding whether to give priority to tax debt would seem to present a straightforward policy choice. The revenue administration (and through them, wider taxpayers) are either given some form of greater protection from the damage of insolvency than unsecured creditors who had some commercial relationship with the debtor or they are put on the same footing as other unsecured creditors.

i) **The state's claims for taxes serve the purpose of financing state functions and the provision of essential services**. This public interest is arguably deserving of preferential treatment over the claims of other creditors, who represent the interests of individuals. Even if there are claims held by individuals worthy of special protection (workers, family dependents, etc.), these persons benefit from the services provided by the state, and therefore tax priorities also represent an indirect benefit to them. The loss of state revenue invariably has an impact on public services with negative consequences for the whole population.[26]

ii) **Tax priority maximizes the amount of tax collected upon initiation of insolvency proceedings.** One of the most common arguments for tax priorities is based on utility and pragmatism – that tax priorities are essential in a tax administration's arsenal of tax collection and enforcement tools. It is in the public's best interest to ensure efficient tax collection and that a country's revenue is not jeopardized. It is argued that tax priorities could promote effective tax

[25] There are studies that have collected data in the past, but these need to be updated. For instance, Babitt and Freiman, 1973, collected data about all the dollar amounts collected in the US bankruptcy system, and in 1969 the tax collected in bankruptcy cases was $11,220,470.

[26] See Keay and Walton, 1999.

collection and enforcement by maximizing the amount of tax debt collection upon the initiation of insolvency proceedings. This is an argument based on the logical assumption that the existence of a priority will result in greater tax being recovered by the tax authority upon insolvency. There is however a lack of empirical evidence as to whether the existence of a priority makes a significant difference in the amount of tax ultimately collected.

iii) **Unsecured creditors deserve to suffer a higher cost than the wider public in an insolvency.** Any extra tax collected because of a priority will ultimately come at the expense of the unsecured creditors of the debtor, rather than of the debtor itself. Since taxes are just a cost of doing business, residency, and citizenship; and unsecured creditors have generally benefited from a taxpayer's economic activity, it could be argued that it is logical to require them to pay the economic entrance fee reflected by certain tax claims[27]. However, it could also be countered that these unsecured creditors have already borne their fair share of the cost of doing business through their own tax liabilities and that there is no clear reason why the tax liability of another participant in the economic system ought to be distributed only to these unsecured creditors and not to all participants in the economy more generally.

iv) **Without tax priorities, powerful private creditors would benefit at the expense of low-income taxpayers**. This commercial justice argument supports the existence of tax priorities to avoid that the distributional scheme in insolvency favors high-income secured and unsecured creditors. Priorities prevent the shifting of cost from secured and priority creditors that typically have stronger economic and bargaining powers to lower-income taxpayers. In this regard, it has been argued that if tax claims do not have a priority or have a low priority, this "*is one basis of the value shift from taxpayers to secured and higher priority unsecured creditors. The strong form of the value-shifting hypothesis suggests that this value-shift is inconsistent with commercial justice because it shifts costs to lower-income taxpayers for the benefit of higher-income secured and priority creditors.*"[28] In practice, existing priority regimes do not seem so effective at preventing shifting costs because secured creditors tend to avoid the impact of tax priorities, since tax priorities typically do not prevail over secured credit. Also, it is not always the case that powerful creditors hold secured claims and that weaker creditors are without protection (e.g., economically powerful actors like banks holding unsecured debts and less powerful workers may be protected by other priorities). In addition, tax authorities can often use the same instruments as private creditors and obtain the treatment of secured creditors by recording liens over the debtor's assets. Of the 58 respondent jurisdictions listed in the 2017 ISORA[29], 39 (i.e., 67 percent) have indicated that the power to obtain a lien over a taxpayer's asset is a "frequently used power", while another 12 have such a power in their tax administration framework but use it infrequently. Only 7 jurisdictions do not have such a power at all. In other words, 87% of the respondent jurisdictions have some form of tax lien.

v) **The state is not a voluntary creditor.** Tax claims are inherently different from most private claims, in that tax claims do not arise out of voluntary agreements between taxpayers and the state but rather by force of legislation. Whereas financial creditors and suppliers decide whether to

[27] See Williams, 1995.
[28] See Hill, 1996.
[29] See https://data.rafit.org/regular.aspx?key=62831423.

grant credit to the debtor or not, and how much risk to assume (i.e., by granting unsecured credit or by using security interests or guarantees to protect their claims), the tax administration cannot select its own debtors: in essence, the tax administration is an involuntary creditor. Certain involuntary creditors, like workers, or tort claimants, are protected by priorities in numerous legal systems.[30] However, not all involuntary creditors are protected by priorities and even where priorities exist, they are often limited in amount (such as a set amount per worker that is given priority).

vi) **The State maintains the insolvency system as a public good and should be compensated for it.** An original argument[31] posits that the insolvency system has been created and maintained by the state. The state covers all the costs of the insolvency courts and its infrastructure, and for that reason it would seem logical that the state is allowed to recover a higher proportion of its claims. This argument does not explain, however, why the costs must be exacted from users of the insolvency system in such a manner, when other more direct ways of financing the system could be conceived, for example, through court filing fees.

vii) **Certain tax claims may be more deserving of priority than others.** For certain types of taxes (such as VAT and withholding tax), it has been argued that a person is merely acting as a withholding agent and is holding the tax amount in trust for the government, and that such tax amount is in fact economically borne by another taxpayer. As such, this amount should not form part of the withholding agent's insolvent estate. Enterprises in distress may be tempted to use these funds to finance their operations. Giving priority to the government for such tax amount ensures that it is not distributed to the withholding agent's other creditors at the expense of its rightful owner—the government. From this perspective, a circumscribed tax priority might be considered equitable. From the point of view of legal technique, the rights of the tax authority over VAT and withholding taxes can be protected by means of a general or special priority, or even by way of a deemed trust, which represents the most powerful tool to ensure that these amounts are used to satisfy the corresponding tax claims. These arguments are at the center of the latest reform in the UK (see Box 1).

Box 1. UK Reform on tax priorities

A recent legislative reform to tax priorities in the UK relied exclusively on the argument that some taxes are more deserving of priority than others. From 1 December 2020, HMRC was made a 'secondary preferential creditor' for certain tax debts. This places those debts before the holders of floating charges and all other unsecured creditors. In describing the reform, the UK stated that the *'reform will only apply to taxes collected and held by businesses on behalf of other taxpayers (VAT, PAYE Income Tax, employee National Insurance contributions, student loan deductions and Construction Industry Scheme deductions). The rules will remain unchanged for taxes owed by businesses themselves, such as Corporation Tax and employer National Insurance contributions.'*

[30] The priority of workers' claims is extremely widespread. Priority for tort claims is not so frequent, although there are several examples of countries recognizing the special position of tort creditors (Russia, Spain). Some academics in the US have proposed the introduction of a priority for tort creditors (Painter, 1984, and van de Biezenbos, 2015, among others).

[31] See Mann, 1995.

The policy rationale presented for the change is summed up by the title of the reform project - 'Protecting your taxes in insolvency[32].' The policy argument put forward by the UK was that the taxes being included in the new priority were those that the business can be considered to be *'temporarily holding that money.'* The argument was ultimately one of 'fairness' with the Government stating that it '*does not believe it is fair that taxes paid by employees and customers should be diverted to other creditors, when these are only held temporarily by businesses whose role is to transfer these payments to the government'.* The reform intended to *'enable more of those taxes paid in good faith to go to fund public services as intended.'*

The UK Government indicated that about GBP 1.9 billion of tax revenue[33] was being lost each year in taxes 'temporarily held' by business as a result of insolvency. The expected increase in the amount of tax that would be recovered by HMRC on foot of introducing this new priority was approx. GBP185 million per year by 2023. This suggests an expectation that the priority could lead to approx. 10% of the lost revenue being recovered each year[34].

viii) **Tax priority is important for its sociological signaling effect.** This argues that tax priorities underscore the paramount importance of taxes in society, by providing for their preferred recovery ahead of other types of debts that a person may have, thus generating a positive sociological signaling effect that promotes tax compliance. This has been described as the "ceremonial effect" of tax priority.[35] However, direct evidence to this effect is thin. While there is some evidence that sociological signaling may serve as an effective behavioral intervention in promoting tax compliance (see Box 2), the signaling involved in these studies focused on emphasizing the moral benefit of compliance (i.e., most of the population is tax compliant) as opposed to the importance accorded to tax compliance by the government through legislation.[36]

Box 2. Does priority affect tax morale?

Existing studies and surveys on business tax morale also do not explicitly examine the correlation between tax priorities and tax morale. A summary of findings of existing studies in an OECD public consultation document shows that a myriad of factors could be responsible for tax morale in a jurisdiction, including tax certainty, tax simplification, perception of government and religion, etc.[37] At least one study (Mickiewicz et al., 2019) based on survey data on business owners/managers in Latvia identified the perceptions of the risk and severity of punishment as a factor associated with higher tax morale in firms, but there could be any number of punishments besides forced liquidation or insolvency (if they should even be understood as punishment at all). Moreover, in most of these surveys governance and corruption (i.e., perception on how revenue is used by the government) are identified as key factors in affecting tax morale, so tax priority in and of itself may not result in the desired sociological signaling effect in the absence of good governance and state legitimacy.

[32]The tone adopted by the UK in promoting their 2020 reform stands in stark contrast to the policy debate in 2002 when longstanding tax priorities were abolished with cross-party political support. One opposition Parliamentarian summed up the consensus position by stating *'On the Bill's insolvency provisions, we welcome the abolition of Crown preference—who would not?'*

[33] See 'Protecting your taxes in insolvency: Summary of Responses to Public Consultation' 11 July 2019 at 3.

[34]It is unclear if this approximation accounts for the knock-on effect of less tax being paid by the other unsecured creditors whose recovery (and therefore income) will be reduced by the GBP 185 million extra being recovered by HMRC.

[35] See Babitt and Freiman, 1973, who refer to this effect with the following words: "*the psychological importance of according a priority to the sovereign is of great significance in maintaining the respect necessary for the system to work*".

[36]See Kettle et al., 2016.

[37]See Olate, Orozco, and Stead, 2019.

ix) **Tax priorities have a deterrent effect on taxpayers defaulting on tax payments**. This argument relies on two assumptions. Firstly, it assumes an increased willingness by the tax administration to enforce tax debts by way of insolvency where a priority exists. It should be noted that tax priority as a deterrent would be effective only if the tax administration acts consistently and regularly in invoking insolvency proceedings (see Box 3, on the role of tax authorities in insolvency). For tax priority to have an actual deterrent effect on taxpayers, there must be a perception that the tax authorities are willing to invoke bankruptcy proceedings. Secondly, it assumes that taxpayers would respond to a more activist revenue by paying tax in a timelier manner.

x) **Tax priority is important for discouraging tax evasion through bankruptcy.** This argument assumes the existence of opportunistic taxpayers that file for bankruptcy before the tax administration has a reasonable opportunity to enforce the collection of their tax debts. It also assumes that some debtors would prefer that other unsecured creditors are paid a greater share from the insolvency estate rather than the tax authority. From an economic point of view however, a taxpayer should be indifferent that, in the event of bankruptcy, its money would be used to pay the state or other creditors, unless the debt is not dischargeable[38]. It may be possible to examine the merits of this argument by identifying if tax motivated voluntary insolvencies increase following removal of priority in a country. This could perhaps be examined if data were available on the size of outstanding tax liabilities for taxpayers who enter voluntary insolvency proceedings both before and after the removal of the priority.

Box 3. Role of the Tax Authorities in Insolvency Proceedings

The arguments in favor of tax priorities assume that the tax authorities are well placed to launch and engage in insolvency proceedings that are often complex and time consuming. IMF staff experience through TADAT (Tax Administration Diagnostic Assessment Tool) assessments have found that there are often significant challenges in this regard.

There are however actions that tax authorities can take to better manage tax claims during complex insolvency proceedings including:

- Specific units in the collection department to follow up these proceedings.
- Building capacities of the tax officials on these matters strengthening the specialization.
- Strengthening the legal framework and capacities to prosecute tax fraud in the collection phase which is increasingly more frequent.
- Reinforcing capacities to prosecute punishable insolvencies.
- Incorporating in the tax procedure code liabilities related to administrators and practitioners' insolvencies.
- Establishing mandatory electronic communications between the tax administrations, insolvencies administrators, board of creditors, and judiciary bodies.
- Creating the legal conditions in which the RA can effectively act in these insolvency proceedings to defend the collection of the tax debt.

[38]Non-dischargeability is an attribute of the debts that the debtor must pay even after a bankruptcy proceeding. Non-dischargeability is distinct from priorities, but it also represents a special treatment of the claims that benefit from it.

- Ensuring the RA's active participation in creditor committees and creditor meetings.
- Guidance for approval of reorganization plans or restructuring agreements in insolvency.

From a broader perspective, tax authorities should design compliance strategies in outstanding debt and return management for a "PREVENT, ASSIST, RECOVER and ENFORCE" strategy that emphasizes prevention and maximizes recovery.

B) Arguments against tax priorities

The opposition to tax priorities has grown and evolved in recent times. Rejecting priority status for tax claims is an alternative policy choice. Under a traditional tax priority regime, unsecured creditors (who often have direct business relationships with the debtor) are subordinated to government claims despite having arguably less capacity to absorb losses than the state. Arguments against tax priority are based on comparisons of the situation of the state versus that of private creditors.

i) **The state is the most powerful creditor.** Priorities are designed to protect weak creditors. Traditionally, the law allows the creation of security interests to facilitate financing to debtors and to allow creditors with bargaining power to protect their own position[39], whereas priorities are reserved for weaker parties that are not in a position of negotiating with the debtor for a security interest or a guarantee. Priorities afford protection to those creditors that cannot bargain for it: examples include priorities for workers, consumers, or tort creditors. In contrast, the state has ample information on most debtors (there is a clear information asymmetry between the state and most creditors)[40]. The state has vast material and human resources, and multiple legal tools to ensure compliance with tax obligations, including special judicial and administrative enforcement regimes in many countries. The state is the most powerful creditor and does not need the added protection that priorities provide.[41]

ii) **The state is the wealthiest and most diversified creditor.** The state is not only the creditor who has the most effective legal tools and powers and the most abundant human and material resources: it is also the wealthiest creditor. In any insolvency case, no matter the size of the household or enterprise, the tax at stake will always be a small amount of total revenue to government, but the claims held by other creditors (workers, suppliers, banks) may represent an important amount for their relative size. From this, it follows that the losses in a single insolvency case are largely irrelevant to the tax administration but can be extremely significant for a small enterprise or an individual. The state is the most diversified creditor in any country,[42] and therefore does not need priorities to protect itself from the damage of the insolvency of a taxpayer, or a number of taxpayers.

[39]Strong trade creditors can also protect themselves by including reservation of title clauses or by using functional equivalents, such as security interests over movable assets.

[40]However, Babitt and Freiman, 1973, indicate that the tax administration has less information than the debtor's counterparties, such as trade creditors. The differences in the available technology must be considered.

[41]Buckley, 1986, indicates that the powers of the state more than compensate for the involuntary nature of the tax claims.

[42]See Ziegel, 1995. Oei, 2014, opposes this argument, indicating that actually the state has constraints to diversify (for instance, the state cannot adjust the tax rates to reflect the bankruptcy risk of each taxpayer).

iii) **The state does not fit the class of "involuntary creditor."** Although it is often argued that the state is an involuntary creditor, the situation of the state is quite different from that of tort victims or infants who are due their alimony payments. In fact, the state has decided, by use of legislative powers, who are the persons who owe taxes. More than a case of the state being an involuntary creditor, it is rather the citizens who are "involuntary debtors" since the tax claims arise independently of their will. In some cases, the state targets certain companies or economic sectors with special taxes, thereby selecting debtors and creating liabilities that they should pay. This is entirely different from the position of involuntary creditors, who lack any control over the relationship that generates a claim, and for that reason should be entitled to a higher degree of protection.

iv) **Tax priorities undermine the ranking of claims.** All priorities interfere with the contractual treatment of claims – they deviate from freedom of contract between debtor and creditors, substituting a legal rule for the ordinary treatment of claims. Absent priorities, the only existing mechanisms for creditor protection would be guarantees and security interests, which would leave proportional treatment (*pari passu*) as the default rule for the treatment of creditors in the event of insufficiency of the debtor's assets. In this regard, *all priorities* represent anomalies. The existence of substantial tax priorities, which benefit numerous different taxes, for important amounts of money, represents a significant deviation from the proportional treatment of creditors[43]. In addition, the impact on the proportionality principle is not easily predictable: blanket or general tax priorities, i.e., priorities that benefit all tax claims, multiply their impact with the multiplication of taxes. This contrasts with other priorities, for instance the priority given to labor claims, which is in most countries limited to amounts necessary to support workers and their families. To counter this argument, it has been said that the objective of proportional treatment of creditors is rarely achieved. This argument suggests that, as there are so many deviations from the *pari passu* principle in practice '*the general rule in insolvency law, its deeply embedded norm, seems to be that the assets available in insolvency are to be distributed "unequally".*[44] Factually, priorities and unequal treatment of creditors are prevalent in modern insolvency systems.

v) **Tax priorities encourage and reward inefficiency in tax collection.** Tax priorities encourage government inefficiency in the collection of taxes. Tax administrators can rely on the existence of priorities in the case of insolvency instead of monitoring closely the status of the debtor. Because their claims have a higher probability of being repaid due to tax priorities, tax administrators can afford to be passive, even during the run-up to insolvency, where creditors typically need to balance the need to protect their claims and the continuity of commercial relationships with the distressed debtor. Passivity is the rational course of action for the tax administration: the tax administration does not need to use resources to take monitoring or preventive action. Instead, the tax administration can decide when to start insolvency proceedings (or wait until another creditor or the debtor files for insolvency) and benefit from the priority afforded to its claims. The priorities place the tax administration in an opposing position to that of ordinary creditors, who have

[43]The breadth of tax priorities is combined with an increasing fiscal burden: a commentator described the tax administration in insolvency as a "devouring monster" (Young jr., 1967).

[44]Mokal, 2001.

incentives to protect their claims and to avoid the insolvency of the debtor.[45] Another inefficiency results from the tendency of the tax administration to grant generous instalment plans to large companies, relying on the priorities established in the law. In some cases, this contributes to an image of solvency, whereas in fact companies may be headed for insolvency. Against this argument, it is argued that it assumes that the tax administration has easy access to an efficient bankruptcy regime and has been given a comprehensive suite of effective enforcement powers and that the more aggressive the tax administration is in collecting tax debt the better. A more aggressive tax administration could see shorter time limits for paying taxes, higher interest on late payment of taxes or increased withholding taxes (such as service fee withholding taxes). These changes would all have a knock-on impact. The assumed preference for an activist tax administration also ignores the political balance that needs to be struck in deciding when to launch insolvency proceedings and when to facilitate delayed payment to prevent a business from collapsing. However, tax priorities are effective not only in insolvency, but also outside of insolvency, because the preferential treatment also operates in favor of the tax administration in conflicts with other creditors in debt enforcement. The argument on inefficiency can be addressed by establishing time limits to priorities, as discussed in section 1. Another counterargument is that this argument is based on logic, but not on empirical evidence. It should be possible to establish if there are any broad changes in a tax administration's behavior following changes to tax priorities in a jurisdiction (for instance, volume of debt enforcement actions and insolvency petitions, and use of installment programs for delinquent taxpayers both before and after the removal or inclusion of a tax priority).

vi) **The effectiveness of tax priority as a means of tax collection is overstated.** As indicated before, a priority is a right granted to a creditor against other creditors of the same debtor: the right to be paid before other creditors receive any payment. Therefore, tax priority does not guarantee the recovery of the amounts owed by the debtor -it only ensures that the tax claims will be paid before the claims of other creditors provided there are enough resources in the insolvency estate-. If the debtor is deeply insolvent, even the tax claims will be unpaid. Tax priorities ensure the satisfaction of the tax claims only in the cases where the losses are all absorbed by unsecured creditors and other creditors with a lower position in the ranking. In other words, tax authorities cannot completely rely on tax priorities for the satisfaction of the tax claims in insolvency. Only superpriorities may offer certainty that the tax claims protected by them will be satisfied, but the superpriorities have severe negative effects on other creditors, and on the capacity of the debtor to access credit. Additionally, the effectiveness of tax priorities cannot be examined in isolation: it needs to consider the negative impact that tax priorities may have on the level of tax revenue that can be collected from private creditors as a result of a reduction in the level of their taxable income.[46] This could be illustrated by way of a simplified example (see Box 4).

Box 4. The Relative Impact of Tax Priorities on Total Tax Recovery

[45]This is consistent with the observation that in some countries in which tax priorities have been abolished, like Australia, the tax administration is taking an extremely active approach to enforcement, based on the use of garnishees and director penalty notices (see https://www.ato.gov.au/tax-and-super-professionals/for-tax-professionals/tax-professionals-newsroom/we-re-changing-our-approach-to-collecting-unpaid-tax-and-super, Oct. 22, 2024). See also Villios, 2015.

[46] This argument was first formulated by Garrido, 1998, at 335.

A stylized example shows how tax revenue is affected by the existence of tax priorities. This means that tax priorities produce gains for the tax administration, but not as significant when the impact on other taxpayers is considered.

An enterprise has debts of $50 million and assets of $10 million. The debtor only has three creditors: the tax administration for tax claims for $10 million, a bank with an unsecured loan for $20 million, and a supplier with unsecured claims for $20 million.

If there is no priority, the tax administration would recover $ 2 million, and the bank and suppliers would each recover $4 million.

With priority, the tax administration would recover the full $10 million but the other creditors would receive nothing. This represents an additional loss of taxable income of $4 million dollars for each of these creditors, compared with the situation where there are no tax priorities. If the rate of corporate income tax is 20% in the jurisdiction, the total tax paid by these creditors is likely to be reduced by $1.6 million ($8 million x 20%).

The benefit to the tax administration of the priority is therefore actually $6.4 million ($8 million - $1.6 million). The gains from tax priority are therefore always going to be less than what they appear when focusing only on the amount of tax collected in insolvency.

vii) **Tax priorities negatively affect the debtor and other creditors.** A priority, as described above, is a right that a creditor holds *against other creditors of the same debtor*. Most priorities do not impact the debtor directly, who is essentially indifferent about the distribution of proceeds from the insolvency estate among the various creditors. The debtor suffers an indirect negative effect: the existence of priorities reduces the capacity of the debtor to access unsecured financing. Super-priorities or statutory security interests also reduce the ability of the debtor to access *secured* financing. There are no empirical studies showing the specific impact on access to credit of each of the priorities, but the negative impact of super-priorities was experienced by the financial sector in several European countries during the latest crisis[47]. Apart from the impact on the debtor, the existence of priorities mainly impacts those creditors who must yield to the preferred claims in the insolvency of the debtor. The international insolvency standard includes some references, albeit indirect, to the negative impact of priorities.[48] Creditors suffer the effects of priorities, which increase their losses in the insolvency of the debtor.[49] It has been said that the use of tax priorities is equivalent to "*rob Peter to pay Paul's taxes*."[50] Because tax claims tend to be substantial, the existence of priorities that benefit tax claims has a disproportionate negative impact on other

[47]See Aiyar et al., 2015; IMF, 2017.

[48]The international standard is composed of the World Bank Principles for Effective Creditor/Debtor Regimes and the recommendations in the UNCITRAL Legislative Guide on Insolvency Law. Recommendation 187 of the UNCITRAL Guide (2004) states that "*The insolvency law should minimize the priorities accorded to unsecured claims*". Principle 12.3 of the WB Principles (2021) includes the following statements: "*Public interests generally should not be given precedence over private rights. The number of priority classes should be kept to a minimum.*"

[49]The argument of the damage to creditors is combined with the argument of the meagre results the priority produces for the state. In the words of the Cork Report, 1982: "*the Crown preference visits hardship upon the general body of creditors whilst producing benefits insignificant in terms of total government receipts*".

[50]See Plumb, 1958. See also McNally, 1962.

creditors. The idea that tax priorities represent a punishment to the debtor misses the point that the main "punishment" is for the other creditors. This is particularly striking in the case of sanctions for missed tax payments or failure to comply with any tax obligations: the purpose of such sanctions is to compel the debtor to make the required tax payments. However, in an insolvency situation, the debtor loses the power to make any payments to any creditor, and the priority given to penalties results in the penalty being imposed to the other creditors of the debtor, who are not responsible for the behavior of the debtor and have no possibilities of making the necessary payments to avoid the penalties.[51]

viii) **Tax priorities are inconsistent with fiscal policy goals in economic crises.** In the context of crises, especially systemic crises, the state uses fiscal tools, such as subsidies or soft loans, to alleviate the hardship to vulnerable households and enterprises. In addition, a crisis triggers so-called automatic stabilizers (the reduction in income caused by the crisis represents a reduction in taxes, especially personal income taxes which tend to be taxed at progressive rates). Tax priorities can have a pernicious effect in situations where fiscal measures are necessary to bring the economy back on track. Tax priorities will actually amplify the negative effect of tax claims over third parties at a time of crisis, as described in the example above (under *v)*). In this regard, the state will be pursuing contradictory policies: on the one hand, trying to support households and SMEs, including with direct payments; and on the other hand, seeking to recover with preference in the insolvency of taxpayers. In a crisis, the creditors of insolvent debtors tend to be also vulnerable, especially small suppliers or landlords. The two policy approaches contradict each other.

ix) **Tax priorities generate litigation.** In general, a system without priorities results in a much easier distribution scheme, and better alignment of the interests of creditors within insolvency proceedings. In the origins of insolvency, in the Middle Ages, the principle was to distribute the losses proportionately among all creditors (*pari passu*). This principle not only had the advantage of minimizing the losses of all creditors, but it also presented the easiest and least contentious solution to the distribution of the proceeds of an insolvency estate. In contrast, legal systems with complex ranking of claims, and proliferation of priorities, tend to generate litigation over the recognition and graduation of claims. This is logical, since the recognition of a substantial preferential claim—for instance, tax claims for several fiscal years—may imply that unsecured creditors will not receive any payment at all. This creates a strong incentive for litigation by unsecured creditors. However, it should be recognized that tax priorities are just one of many deviations from the proportionality rule. Removal of tax priorities by itself would probably not make complex insolvencies much simpler or significantly reduce litigation. No empirical studies have analyzed this potential effect.

x) **Tax priorities are opaque.** One of the major differences between tax priorities and secured credit is that the latter is subject to rules of publicity that generally involve filing a record or a notice in registries that are accessible to the public (such as real estate or movable collateral registries). Registration of security interests over real estate is the rule in all modern legal systems. Regarding movable collateral, there is more variety in practices: the international standard recommends the

[51]For these reasons, some countries establish that tax penalties are *subordinated* claims in insolvency (i.e., the penalties can only be paid after unsecured creditors have been paid in full).

establishment of notice-based registries for all classes of movable collateral.[52] There are cases of high-value movable assets where the registry operates along the lines of real estate, and these commonly include ships, airplanes, heavy machinery, and intellectual property. There are also instances of security interests over movable assets where there is no registration, although there are techniques that can fulfill a similar function in alerting other creditors and third parties of the existence of a security interest over the asset (such as dispossession of the debtor or control by the creditor). However, tax priorities are normally not associated with any measure that would disclose their existence and amount to third parties. Creditors cannot access information about the existence and extent of tax priorities, whereas these tend to be much more significant in amount than the other priorities (especially, labor claims). In other words, creditors are left in the dark about the impact that tax priorities can have on their claims in the event the debtor becomes insolvent. The existence of large undisclosed tax liabilities may even contribute to an appearance of solvency.[53] Statutory security interests or liens in favor of tax authorities represent an exception since they tend to be subject to the same filing requirements as regular security interests. Some countries, such as France, and the countries in OHADA, have reacted to the problem of the lack of publicity of tax priorities by establishing the duty of the tax authorities to inform the public about the existence of substantial tax liabilities of debtors (see Box 5).

Box 5. Transparency of tax claims

France reacted to the problem of the lack of publicity of tax priorities by establishing the duty of the tax authorities to provide publicity to tax claims after a debtor reaches a certain threshold in unpaid tax obligations. The system was introduced in France in 1966, when it was established that tax claims for more than 80,000 francs needed to be included in a special registry at the courts. An omission to file the claim results in the loss of priority.

This system is included in the General Tax Code (art. 1929 quarter). The taxes covered by the legal rule are the following: personal income tax, corporate income tax, tax over salaries, real estate taxes of enterprises, taxes on the sales of enterprises and indirect taxes. The threshold that triggers the obligation to register is set by decree. Until 2019, that threshold was set at 15,000 euros, but a new decree established that the obligation is only triggered after the amount of unpaid taxes reaches 200,000 euros. This has resulted in a reduced effect of the transparency requirement.

The solution of introducing transparency for tax claims addresses one of the criticisms against priorities, namely the negative effect of tax priorities on creditors because of the lack of information about the existence of substantial tax claims.

This French technique had a decisive influence in the legal regime of OHADA, the uniform commercial law regime that applies to 17 African countries. Under the uniform OHADA on security interests, there are general priorities for tax and social security claims, but above a certain threshold (the legal threshold for provisional enforcement of claims, which is set at the national level), these require to be registered at the Commercial Registry to be effective. The registration needs to be done within six months of the claims being due and lasts for a 3-year period (art. 181 of the OHADA Uniform Securities Act). The registration can be renewed.

[52] See World Bank Principles, Principles A3 and A5; UNCITRAL 2007.
[53] See O'Donovan, 1990.

xi) **Tax priorities are historic relics.** Tax priorities originated in Roman law and in the Middle Ages. They correspond to a world where the position of the state as a creditor implied the exercise of sovereignty, to be asserted over all other creditors. Private parties were regarded as inferior to the *fiscus*, in Roman law, or to the king, in the Middle Ages.[54] The lack of a priority would be entirely inconsistent with this world view, where the difference in status demands precedence in all areas, including in the satisfaction of claims[55]. Therefore, the priority of tax claims would mean just the logical consequence, in insolvency terms, of the differences in status of the state and private citizens. This position is in contrast with the modern administrative state, where the state authorities are subject to the rule of law and the state is in the same position as citizens, unless the public interest demands otherwise. This is reflected in the international standard for insolvency, which indicates that "*public interests generally should not be given precedence over private rights*."[56]

IV. Is the Debate Resolvable?

The arguments for and against tax priorities show that views expressed in the literature are deeply entrenched which suggests that there is little space for consensus. The number and variety of arguments deployed by proponents and detractors of tax priorities is remarkable, although some arguments are rather incidental and can even distract from the main focus on the economic effects of tax priorities. A review of the legislation however suggests that there may be more common ground than appears from the debate. As countries have removed or reduced some priorities, most countries fall on a spectrum between absolute positions and are less often on opposite ends of it.

As indicated before, the question of the distribution of damage in insolvency comes down to a policy choice. There are two critical points in the most fundamental arguments for and against tax priorities that need to be tested, namely:

- That priorities increase the amount of tax collected by tax authorities.
- That the amount of tax collected in insolvency is very small relative to a country's total tax revenue, but it is significant if compared with what other creditors receive.

While both assumptions make logical sense, there has been little evidence published as to the extent to which they are true. This highlights the lack of empirical data on the basic assumptions underlying this debate.

A key consideration is whether tax priorities are effective as a means of recovering taxes. Tax priority does not guarantee the recovery of the amounts owed by the debtor - it only ensures that the tax claims will be paid before the claims of other creditors provided there are enough resources in the insolvency estate. If the debtor is deeply insolvent, even the tax claims will be unpaid. Tax priorities ensure the satisfaction of the tax

[54]See Ben-Ishai, 2004.

[55]See Marsh, 1967, at 729: "*does the traditional rule which has granted priority to all tax claims, at least over all general non-priority creditors, rest upon anything more than a naked assertion of power based upon the fact that this particular creditor happens to be writing the rules of distribution?"*

[56] See World Bank Principles. Principle C.12.3.

claims only in the cases where the losses are all absorbed by unsecured creditors and other creditors with a lower position in the ranking. In other words, tax authorities cannot completely rely on tax priorities for the satisfaction of the tax claims in insolvency. Only super-priorities may offer certainty that the tax claims protected by them will be satisfied, but super-priorities may have severe negative effects on other creditors, and on the capacity of the debtor to access credit.

In contrast, it has been argued that the negative impact of priorities on other creditors may have been overstated. The debate on tax priorities presupposes that the existence of a priority has a meaningful impact on the distribution of assets during insolvency. An alternative position has suggested that the impact of priorities may be relatively minor given overall low rates of recovery for any unsecured creditors. The elimination of tax priorities would only result in very low increases of recovery for unsecured creditors.[57] However, this argument compares the amount received by the tax administration by way of priorities with the amounts received by unsecured creditors as a class, or as an average. The fact is that unsecured creditors are in extremely varied positions, and every insolvency case is also different. The main point, again, is that the distribution of the amount that tax authorities would receive by virtue of their priorities among various unsecured creditors, in multiple insolvency situations, would always be more impactful for the individual unsecured creditors than for the tax administration.

It has also been argued that levels of recovery in general under insolvencies are so low that priorities have little practical effect. This “nihilistic” approach to the issue would actually imply that the whole debate is meaningless. Although reforming priorities may have less effects than anticipated,[58] collection of data on recoveries in insolvencies can provide accurate information on distributions, and this information is also extremely useful to address inefficiencies in insolvency procedures.

The limited country data that is available supports this argument. As Table 1 demonstrates, it is noticeably clear that the state does not depend on the income generated by the operation of insolvency proceedings. This simple fact puts the whole debate on tax priority in perspective and lends support to the argument that, despite the intensity of the arguments, the debate may be not so relevant from the perspective of the public interest. This is also consistent with the observation that countries that have abolished tax priorities have not experienced problems in public finances that can be attributed to the loss of the priorities.

On the other hand, it is much more difficult to assess what is the impact of the priority over the rest of the creditors. The difference in priorities can be very significant for certain creditors in specific insolvency cases since the direct impact on their own claims can only be measured by reference to the size of their balance sheets. In any event, it is likely that the damage these private creditors suffer because of the priorities is disproportionately high when compared with the impact that the tax administration would experience with the reduction or elimination of the priorities.

[57] See Mokal, 2001, who estimated that the impact of abolishing tax priority would see the recovery rate for the average unsecured creditor in UK insolvency cases rise by less than half of one percent (from 7% to 7.4%). He suggested that the increase in recovery in an overwhelming majority of formal insolvency proceedings was unlikely to go up to the extent that such creditors would be appreciably better off. It could be possible to verify this assertion by examining data on the level of recovery for unsecured creditors in the UK during the period that tax priority was completely removed.

[58] See McCarthy, 2020, who suggests that the limited available empirical data on recoveries for creditors suggests that '*changing the hierarchy of creditors' claims to nominally suit one class over another cannot have as significant a practical effect as creditors may imagine'.* In considering the introduction of any new priority he noted that the that the reality of corporate insolvency and the minimal amounts available for distribution *'can make a tokenistic gesture of the granting of newly preferential status to a group of creditors'*

Table 1: Amount of Tax Recovered on foot of insolvency proceedings in certain jurisdictions

	United Kingdom	Ireland	Sweden	Jamaica
Type of priority given to tax	Priority only given to certain taxes (including VAT)	General priority for all tax debt (limited to one tax year)	No general priority for tax	No general priority for tax
Percentage of annual tax take recovered in insolvency cases - 2022	-	0.03%	0.0005%	0.0005%
Percentage of annual tax take recovered in insolvency cases - 2023	0.03%*	0.01%	0.001%	0.0004%

Source: Data provided by the tax authorities in each country.
*The UK figure relates to tax year 2022-23

There are some conclusions that can be drawn from the debate that may impact the design of priorities in case these are used. Any priority should be designed as narrowly as necessary to achieve the objective and with sufficient clarity so that it is certain which types of taxes are included and which are excluded. It is useful to have time limits for priorities (time limits reduce the impact of priorities and encourage diligent action by tax authorities). Priorities have a stronger justification when the debtor is holding sums of money on behalf of the tax authority (VAT, income tax for workers). On the other hand, the priority treatment for fines does not have a strong justification. In any event, legislators should make clear the rationale for their policy choices and assess and base any decision on actual data.

The major challenge in resolving the debate on tax priorities is the absence of data that shows the effectiveness of insolvency proceedings in the collection and recovery of tax claims. There have been isolated studies on tax recoveries in insolvency,[59] but not studies that show historical trends in a particular country, or regular reports that allow cross-country comparisons.

Building on the discussion above, it is crucial to examine the type of evidence that should be collected and how various sources could help to resolve the debate. Of most value is likely to be an examination of countries that have made substantial legislative changes to their tax priorities in recent decades. While often the removal of tax priorities will have been part of a broader reform of insolvency provisions, there would still be significant merit in identifying whether any constant trends can be identified. In particular, it would be enlightening to identify whether the introduction or removal of a tax priority led to clear and quantifiable changes in:

- the number of insolvency proceedings commenced by tax authorities, on a yearly basis.
- The willingness of the tax administration to allow taxpayers to avail themselves of installment payments.
- the percentage of tax debts recovered on average during insolvency proceedings
- the percentage of recovery made by unsecured creditors on average during insolvency proceedings.
- the overall rate of tax compliance within the country and the estimated amount of revenue lost from non-compliance (often called the 'tax gap').

[59] A limited study by Professor Ziegel in Canada compared the recovery obtained by the tax authorities (with priorities), at 20 per cent of the claims, as opposed to a 6.5 percent recovery by unsecured creditors (Ziegel, 1989).

Each of these data points refers to one or several arguments in favor or against tax priorities that have been described in the previous section. However, many of those arguments are of limited value and are far from decisive. In addition, the data collected needs to be analyzed considering that factors other than priorities may have a major influence.

Cross-jurisdiction comparisons can offer some insight but are of limited value given the differing factors that influence both tax compliance and insolvency proceedings across jurisdictions. However, an examination of broad trends across countries with tax priorities and those without may help add some additional insight into the merit or otherwise of some assumptions relied on in the debate on tax priorities. In particular, the following data could be enlightening for this debate:

- Total tax collected through insolvency proceedings, relative to the overall tax revenue.
- The percentage of insolvency proceedings in a jurisdiction that are initiated by the tax authority (as opposed to voluntary insolvency or those initiated by other creditors)
- The overall rate of tax compliance within the country and the estimated amount of revenue lost from non-compliance (often called the ‘tax gap’).

Evidence on tax compliance does not suggest a causality link between tax priorities and tax compliance rates. For example, the US has a significant tax gap despite the presence of strong tax priority – the net tax gap is estimated to be USD 696 billion tax year 2022 which, expressed as a percentage of total tax collected of 15%[60]. The large tax gap in the US has typically been attributed mostly to underreporting and diminished resources for audits.[61] In contrast, Australia, which does not have tax priority, has a much smaller income-based tax gap of approximately 7.5%.[62] It would therefore appear that tax priority in and of itself therefore does not necessarily ensure the effective collection of taxes. Other factors, including complexities of the tax legislation and system and the lack of an effective interest and penalty regime[63], could prove to be more instrumental in promoting and ensuring tax compliance.

Limited evidence does not show a clear link between the existence of priorities and a more aggressive use of insolvency by the tax authorities. Empirically, the availability of tax priority in and of itself does not guarantee the frequent use of bankruptcy proceedings by tax administrations. According to the 2017 ISORA[64], out of the 54 participating jurisdictions with the power to initiate bankruptcy or liquidation actions against taxpayers, only 25 (i.e., 46%) use such power “frequently” to assist in the enforcement of tax debts (see Table 2). There appears to be no clear correlation between the exercise of such power and the existence of tax priorities. For example, both France and the US have tax priorities, but the former uses the power to initiate bankruptcy or insolvency proceedings infrequently whereas the latter uses the power frequently. On the other hand, both Germany and the UK use such powers frequently even though they do not have any tax priority. Even amongst countries with some degree of tax priority, the frequency of use of bankruptcy powers varies (frequently in South Africa and infrequently in Singapore). The lack of a direct relationship between tax priorities and the actual rate of use of bankruptcy as a tax enforcement measure is not surprising, since there could be

[60] See IRS: The tax gap | Internal Revenue Service

[61] See “Understanding the Tax Gap and Taxpayer Noncompliance”, Testimony of The Honorable J Russell George, Treasury Inspector General for Tax Administration to the Committee on Ways and Means of the U.S. House of Representative, May 9, 2019, available at: https://www.treasury.gov/tigta/congress/congress_05092019.pdf.

[62] This was computed based on figures taken from the ATO website for tax year 2021-22. See Tax gap program summary findings | Australian Taxation Office

[63] See Waerzeggers, Hillier and Aw, 2019.

[64] https://data.rafit.org/regular.aspx?key=62831423

many other reasons why a tax authority would initiate such actions even without tax priority (e.g., lack of other effective enforcement powers in the tax laws, stigma associated with bankruptcy in certain societies or cultures, etc.) or why such actions are not initiated even where the tax claims benefit from priorities (e.g. because of high costs and/or the inefficiency of insolvency proceedings). There also appears to be less willingness on the part of lower-income and small-state jurisdictions to use forced bankruptcy to enforce tax collection.[65]

Table 2: Survey asking 157 tax authorities how frequently they use various powers to assist in enforcement of debt

Powers to assist enforcement of debt	Frequently used power	Infrequently used power	Power never used	Power does not exist
Obtain a lien over a taxpayer's assets	105	32	1	19
Impose liability on company directors for certain company tax arrears	70	57	3	27
Initiate bankruptcy or liquidation actions	68	59	11	19
Publish names of debtor taxpayers	54	16	6	81
Deny delinquent taxpayers access to certain government services	32	25	8	92
Temporarily close a business or withdraw a license	16	49	5	87
Impose restrictions on overseas travel	19	19	8	11

Source: ISORA, 2017

The most critical piece of information for the debate refers to the amount of tax claims collected thanks to the existence of an insolvency priority. In the end, the main argument in favor of tax priorities is that public interests deserve protection, and the main argument against tax priorities is that the tax authority does not need such protection, and the priorities cause more damage to private creditors than benefit to the state. The limited data outlined in Table 1 offers very interesting insights because it is possible to assess the relative importance of tax claims collected in insolvency versus total revenues, in a country where priorities are quite broad (Ireland), a country where priorities have been eliminated (Sweden) and a country that has reinstated some priorities recently (the United Kingdom). A country where tax enjoys limited priority (Spain - fifty percent tax priority) also shows scarce tax revenue from insolvency proceedings (see Box 6). It is clear that in each of these cases, the amount of tax collected is negligible compared to the country's overall tax take.

These data would suggest that the effectiveness of tax priorities as a tool of tax collection and enforcement is far overstated, and on a cost-benefit analysis may not adequately justify the negative impact that they impose on private creditors. However, the data refers to only a small number of countries and the situation might be different in other jurisdictions. There is clearly a need for comprehensive data to settle the question.

Given the limited effect of priorities that appears from the data, it is likely that for most countries more effective tax debt management can be achieved within existing priority frameworks. This would require investing in preventive approaches that avoid tax debts becoming overdue, and in tools to secure their collection before insolvency arises. As the data shows, once insolvency arises there is little chance of successful tax collection, irrespective of the extent of the tax priority.

[65]See Crandall, Gavin, and Masters, 2019 at p.69: "*However, for the direct powers, the higher-income participants use the powers more frequently in every instance than do the small-state and lower-income participants. This suggests a greater readiness on the part of the higher-income jurisdictions to use direct measures such as garnishment or forced bankruptcy. It is quite clear that these tools are significantly less used in the lower-income and small-state jurisdictions*."

Box 6. The Spanish Case

After several unsuccessful attempts, Spain overhauled its insolvency law in 2003: one of the areas extensively reformed was the ranking of claims, with the elimination of numerous priorities, the introduction of some targeted priorities in favor of certain creditors and the reduction of the extent of tax and social security priorities. The treatment of tax priorities included some innovations:

- Tax priorities were retained, but only as a general priority, and placed in the ranking after other claims. The priority only covers 50 percent of the claims held by the tax administration.
- The priority for the amounts withheld for VAT and workers' income tax and social security contributions was retained and not subject to the 50 percent cut. It occupies the second position in the ranking of general priorities, just after workers' claims.
- Penalties and penalty interest are subordinated, in consideration to their different nature and of the fact that giving them a priority—or even unsecured treatment—would essentially punish unsecured creditors.
- The law also recognizes the possibility of creation of security interests in favor of tax claims (so-called special priorities). These priorities need to be registered in accordance with the general rules – the only exception is the statutory mortgage for the last annuity of real estate tax, which operates without being registered.

The Spanish tax administration compiles data that shows the revenue from insolvency cases. The revenue breakdown reflects the payments attributed to ongoing and completed insolvency proceedings, as well as voluntary and forced payment of taxes. The reason for this distinction is that in modern insolvency law, most debtors continue their business activities at least temporarily, and the continuation of activities generates new taxes, which must be paid by the debtor or the insolvency administrator. These taxes do not raise any particular issue, since they are classified in all legal systems as administrative expenses (i.e., these taxes are satisfied in full as they fall due and there is no conflict between these claims and the claims of creditors in the insolvency proceedings). The full data is set out in Annex II.

The data highlights a few interesting points:

- Income from forced payments in insolvency (i.e., tax collected as a result of the insolvency) was €218 million in 2018 and €162 million in 2019.
- By contrast the total Spanish tax take in those years was €208 billion and €212 billion.
- The tax collected under insolvency is therefore approx. 0.1% of the total Spanish tax take each year.
- As the tax claims enjoy a 50 percent priority, this means that, *as a maximum*, revenue would have increased to €436 million and €324 million if priorities would have been restored in full. This shows that the effect of priorities on tax collection is limited, particularly in the context of the overall tax revenue of a state.

The information published by the Spanish authorities was of great interest for both tax and insolvency researchers (see Annex II). Unfortunately, the publication of these reports has been discontinued in recent times.

V. Conclusion

The debate over tax priorities in insolvency represents a fundamental tension between public and private interests that continues to challenge policymakers worldwide. This paper has presented the most comprehensive comparative analysis to date of how legal systems across the globe treat tax claims in insolvency, identifying the diverse techniques used to protect these claims and documenting a significant shift among advanced economies away from traditional preferential treatment. We have systematically organized and evaluated the competing arguments from both sides of this debate - those defending tax's privileged ("royal") status and those advocating for its demotion to equal standing with other creditors. The striking diversity of approaches implemented by countries reflects both the complexity of the issue and the absence of empirical evidence that would settle many of the theoretical arguments. Despite decades of scholarly debate and legislative reforms, there remains no clear consensus on whether tax should indeed be "king" in insolvency proceedings, though the trend in advanced economies suggests a gradual reconsidering of this historical privilege.

Tax priorities are the result of a policy choice. There are a wide variety of arguments for and against the existence of tax priorities in insolvency, but ultimately the introduction or the abolition of tax priorities is a policy decision that goes beyond both tax law and insolvency law.[66] While it would be beneficial for policymakers to be transparent about the motivations behind the continuation or abolition of tax priorities, ultimately, this policy decision is largely motivated by the will to protect public interests or the will to minimize the negative consequences of insolvency for the private sector. However, some of the arguments are fundamentally theoretical in nature and rely on assumptions as to behavioral effects of different approaches to tax priorities.

Decisions on tax priorities should be based on empirical evidence. Legislators should be aware of the costs and benefits of each policy choice, as well as of their side-effects rather than evaluating theoretical arguments. There is however a significant lack of publicly available data that can be used to evaluate the decision to have, or not have, a tax priority. Gathering empirical data on the effects and impact of tax priorities in insolvency should be a foundational step towards the assessment of the legal regime and the proposal of reforms.

Notwithstanding the debate, it appears that the tax amounts at stake in insolvency cases represent a very small portion of a country's tax receipts. This raises the question as to just how economically significant the issue is for the state and whether the existence or absence of a priority is likely to make a major difference in the amount of tax collected or the actions of debtors, creditors, and the tax authorities. The debate, however, can ultimately only be progressed through the collection of data by tax authorities as to the actual impact of tax priorities in reality.

[66] The Insolvency Law Reform Committee of Singapore, 2013, concluded that "*there are good reasons for considering the abolition of the preferential status of tax claims. However, it is an issue which is intertwined with the policies and financial considerations of the Government and the Committee defers to the views of the Government.*"

Annex I. Treatment of Tax Claims in the Insolvency Regime of Selected Countries[1]

Explanatory note: the regime of tax claims in insolvency presents challenges for its research. There is no universal practice regarding the legislation of tax priorities. In a majority of countries, the insolvency law includes the ranking of claims to be applied in the case of the insolvency of the debtor, and the position of tax claims can be determined in the insolvency law (however, many countries have separate statutes for corporate insolvency and for personal insolvency, and the treatment of tax claims may be different). Other countries include the ranking of claims in their civil or commercial code, or in special legislation. Finally, there are countries where tax priorities are included in tax legislation, which raises the issue of the coordination of tax legislation with insolvency law.

The following table includes characteristics of the treatment of tax claims in insolvency in selected countries. The sixty countries included in this list are representative of both civil law and common law legal families, advanced economies, emerging markets, and low-income countries, and all geographical areas of the world. The sample of countries represents 91 percent of the world's GDP and 84 percent of the global population.

Country	General Priority	Limits in Time or Amount	Ranking	Treatment of VAT or Withholding Taxes	Special Tax Priorities	Fines and Interest
Argentina	√ art. 246.4, Insolvency Law	General priority claims cannot take more than 50% of the debtor's total assets after special preferences are paid (art. 247 Insolvency Law)	Ranking below special priorities and after general priorities in favor of labor claims (and at the same level of social security claims)	No provision	Taxes that refer to specific assets have a special priority (art 241 of the Insolvency Law).	No priority
Australia	X	N/A	N/A	No provision	N/A	No priority
Austria	X	N/A	N/A	No provision	Legal pledges perform a similar function	No priority
Bangladesh	√ section 75 Bankruptcy Act	No limits	First priority, after administrative expenses and insolvency administrators' fees (section 75 Bankruptcy Act)	No provision	No provision	Included in the priority
Belgium	√ art. 27 Tax Collection Code; art. 422 Tax Code	No limits	First priority for withholding taxes. Taxes enjoy a second general priority (art. 19 Mortgage Law; art. 27 Tax Collection Code)	Withholding taxes enjoy the first priority. VAT, priority according to arts. 27 and 28 of the Code of tax collection	Special priorities for taxes referred to specific assets. (Art. 150 Code of registration rights. Arts. 27 and 28 Code of tax collection. Art. 313 of the law of customs)	Sanctions are not included in the priority
Brazil	√ Article 83.III Bankruptcy law, Art. 965.VI Civil Code; Art. 186 National Tax Code	2 years (art. 965.VI Civil Code). But National Tax Code applies without limits, and allows tax administration to ignore insolvency process (art. 187 National Tax Code)	Third ranking, after labor claims and security interests (Article 83, Bankruptcy law). Art. 186 National Tax Code only recognizes the priority of labor claims over tax claims.	Art. 86.IV, Bankruptcy law includes a specific provision for withholding taxes	No provision	Fines are not covered by priority

[1]This table has been prepared by Kika Alex-Okoh and José M. Garrido.

Cambodia	√ art. 57 Insolvency Law	No limits	Article 57, Insolvency Law, ranks after labor claims and secured claims, and before unsecured claims.	No provision	No provision	No specific provision (possibly included in the priority)
Cameroon	√ art. 180. 6 and 181 Uniform Act on Security Interests (OHADA)	No, but requires registration of the claim after a certain legal threshold is met	Last place (sixth) among general priorities. This applies to tax claims within the statutory limit. For the priority to apply above that limit, registration is necessary (art. 181 of the Uniform Act)	No provision	No provision	Included in the priority
Canada	X	N/A	Tax claims are unsecured (exception is the treatment of certain tax claims as protected by deemed trusts)	Deemed trust for withholding taxes	No provision	No priority
Chile	X only priority for withholding taxes (art. 2472.9, Civil Code)	N/A	Ranking is last among a series of nine priorities in the first class of general priorities	VAT, employee withholding taxes and other special taxes are granted a general priority of the ninth rank	No provision	Treatment not specified. Generally, interest on priority claims also enjoys priority (art. 2491 Civil Code)
China	√ Art. 113.2 Enterprise Bankruptcy Law	No limits	Aside from administrative expenses, taxes rank below labor claims and at the same level as social security claims (Art. 113.2 Enterprise Bankruptcy Law).	No provision	No provision	Fines are not covered by priority
Colombia	√ art. 2495.6, Civil Code	No limit	Last place (sixth) of general priorities of the first class (after judicial expenses and labor claims, among other claims of lesser importance)	No provision	No provision	Treatment not specified. Generally, interest on priority claims also enjoys priority (art. 2511 Civil Code)
DRC	√ art. 180. 6 and 181 Uniform Act Securities (OHADA)	No, but requires registration of the claim after a certain legal threshold is met	Last place (sixth) among general priorities. This applies to tax claims within the statutory limit. For the priority to apply above that limit, registration is necessary (art. 181 of the Uniform Act)	No provision	No provision	Included in the priority
Egypt	√ Art. 140 Law on Restructuring, Preventive Composition and Bankruptcy	Priority is limited to taxes owed two years preceding the bankruptcy. Other taxes outside this time limit are treated as ordinary debt - Article 140 Law on Restructuring, Preventive Composition and Bankruptcy	Taxes have second priority after payment of administrative court and judicial expenses related to the proceedings, as well as labor claims. Secured creditors rank above all creditors.	No provision	No provision	Included in the priority (art. 130 of the Law)
France	√ art. 1920 General Tax Code	Need to register when the tax claims exceed the threshold of 200,000 euros (Art. 1929 quater general tax code)	Direct taxes rank at the 12th level. Indirect taxes and custom duties rank at the 14th level. (Art. L643-8, Code of commerce). The ranking is granular, but the categories of claims ranking above taxes include labor claims, judicial expenses, rescue financing, and secured credit.	Covered by general priority, at a lower level	No, protected by general priority	Included in the priority
Germany	X	N/A	Unsecured claim	No provision	Legal pledges perform a similar function	No provision
Ghana	√ section 107 of the Insolvency Act	Yes - priority is limited to all taxes due within 1 year preceding the commencement of winding up proceedings and a limited of employee claims are entitled to priority over the holder of a floating charge	General priority, after fixed charges, and before floating charges. No ranking among claims protected by general priority.	No provision	No provision	Interest is included in the priority but has a lower ranking if it exceeds five percent the Bank of Ghana's policy rate (section 107 of the Insolvency Act). No provision on penalties.

Haiti	√ art. 1868 Civil Code	No limits, but tax claims need to be registered to enjoy priority (arts. 1874 and 1874 bis of the Civil Code)	Taxes rank in the last place of general priorities over movable assets (sixth), after judicial expenses, labor claims, and other claims of lesser significance.	No provision	No provision	No provision
Honduras	√ Article 1521 Commercial code, referring to special tax laws, i.e., art. 149 of the Tax Code)	No limits	Full priority, only yielding to alimony and labor claims (art. 149 of the Tax Code)	No provision	No provision, but covered by general priority	No provision
India	X Tax claims are placed at the level of unsecured creditors (section 53 IBC). Priority over unsecured creditors only for insolvency of natural persons (section 178 IBC)	Yes - for the priority in personal insolvency, such priority is limited to two years of tax claims owed to central state or local governments (section 178 d) IBC)	No priority for companies (s. 53 IBC). For the priority in personal insolvency, such priority is recognized after secured credit, administrative expenses, and labor claims (section 178 IBC)	VAT enjoys a statutory security interest (first charge, s. 48 GVAT Act). See the case State Tax Officer vs. Rainbow Papers Ltd., resolved by the Indian Supreme Court (Sept. 6, 2022).	No provision	No provision, but interest is included for the priority in the insolvency of natural persons. Interest after commencement of insolvency only covered if there are sufficient assets (art. 178(5) IBC)
Indonesia	√ art. 1137 Civil Code)	Limit of two years (indirect source, this must be in tax legislation)	Priority after secured credit, administrative expenses and labor claims, and other claims of lesser significance (art. 1141 Civil Code). Unclear whether tax legislation sets a higher ranking. Secondary sources put taxes in the highest position, even above secured creditors.	No provision	No provision, but covered by general priority	Included in the priority
Iran	X Art. 58 of the Act of Administration of Bankruptcy of 1939 includes the ranking and does not mention taxes	N/A	N/A	N/A	N/A	N/A
Ireland	√ section 621 Companies Act	Time limits set for the taxes which have priority (in column G) under Section 621 (2)(a)(i)(iv) Companies Act (12 months)	General priorities rank after fixed charges and before floating charges. Preferential claims are all at the same level (tax claims and various labor claims) (section 621 Companies Act)	Included in general priority, with a 12-month limit	No special priority	Included in the priority
Israel	√ section 234 of the Insolvency Act	Some limits: 12 months for VAT; 3 years for taxes	Priorities are below fixed charges and below floating charges (which are limited to 75 percent of proceeds). General priorities are ranked as follows: first labor claims; second, taxes withheld on salaries; third, alimony; fourth, VAT; fifth, other taxes and social security claims (section 234 of the Insolvency Act)	Included as separate items in the ranking of general priorities. VAT has a 12-month limit, withheld taxes on salaries have no limit.	Super-priority for taxes over real estate taxes (section 11(A)1 of the Tax Ordinance (Collection)	Penalties are subordinated debts (section 237 of the Insolvency Act)
Italy	√ art. 2752 Civil Code)	No limits for the general priority. Some limits for special priorities.	General priority over movable assets. The priority of taxes ranks after labor claims and some less significant claims, and before social security contributions. National taxes prevail over local taxes (see arts. 2751-2754 Civil Code)	VAT grants a special priority over assets and services (art. 2758 Civil Code) and real estate (art. 2772 Civil Code)	Indirect taxes have special priorities over the assets to which they refer (art. 2758 Civil Code), including real estate (art. 2772 Civil Code). Direct taxes also have a special priority over movable assets of the enterprise, limited to 2 years of taxes (art. 2759 Civil Code)	Sanctions and penalty interest are expressly included in the priority (art. 2752 Civil Code)

Japan	√ Art. 148 (Claims in the Scope of claims on the Estate) and art. 98 (Preferred bankruptcy claims) of Bankruptcy Act, referring to special laws	First priority is limited to taxes that become due within one year preceding the bankruptcy (these tax claims are treated as administrative expenses)	There are two levels: taxes that become due in the year precedent to commencement are classified as administrative expenses and therefore enjoy a "super-priority". The rest of taxes have a general priority, together with labor claims.	No provision	No provision	Penalty tax and delinquent tax are to be included in the scope of subordinate bankruptcy claims. (art 99 (1) (i) and 97 (1) (iii) (v) of Bankruptcy Act)
Jordan	X (no reference to taxes in section 38 of the Insolvency Act). There is a general priority for solvent liquidation (art. 256 of the Companies Act)	N/A	N/A in insolvency. In solvent liquidation, second priority, after labor claims (art. 256 of the Companies Act)	No provision	Indirect taxes are covered by the general priority, but only for solvent liquidation	Penalties and penalty interest are subordinated (art. 41 of the Insolvency Law)
Kenya	X There are priorities for certain taxes (Insolvency Act Second Schedule), but these do not cover tax claims generally	N/A	The first priority includes administrative expenses. The "second priority" level includes, together with labor claims, tax amounts deducted from salaries and banking services; the "third priority" includes withholding PAYE taxes, non-resident withholding tax, resident withholding tax deducted by the company under the Income Tax Act and custom and excise duties.	Amounts deducted by the company from wages or salaries (income tax) is treated as a second priority claim; non-resident withholding tax, resident withholding tax deducted by the company under the Income Tax Act are treated as third priority claims	No provision	No provision
Korea	X Article 179(9) of Debtor Rehabilitation and Bankruptcy Act includes a list of taxes that benefit from priority, but there is no priority that applies generally to all taxes.	N/A	Some specific taxes are included in the ninth level of the ranking of general priorities (art. 179 of the Debtor Rehabilitation and Bankruptcy Act). The deadline for payment of these taxes must arrive after commencement of the case. These include withheld taxes, VAT, local taxes, and some special taxes.	Withholding taxes (subject to Article 67 of the Corporate Tax Act), VAT are covered by the ninth priority under Section 179 of the Debtor Rehabilitation and Bankruptcy Act	No provision	No provision
Kyrgyz Rep	X Tax claims are subordinated to those of unsecured creditors (art. 87 Bankruptcy Act)	N/A	Taxes rank below unsecured claims (fourth priority, art. 87 of the Bankruptcy Act).	No provision	No provision	Penalties and interest are further subordinated (fifth level in the ranking of claims)
Malaysia	√ section 527(1) of the Companies Act)	No limits	Taxes are the last priority among general priorities, ranking below administrative costs and labor claims (section 527(1) of the Companies Act)	No provision	No provision, but covered by general priority	Not expressly included, but the law refers to "all federal tax assessed" before commencement or before the end of the submission of claims period
Mexico	√ art. 221 of the Commercial Insolvency Law)	No limits	Taxes rank below singular privileges (medical expenses and funeral expenses) and secured credit, but above special priorities. Taxes rank together with labor claims, although there is a part of labor claims that are classified as an expense of the procedure and are satisfied in precedence to all claims, including secured claims.	No provision	No provision, but covered by general priority	Included, according to art. 4 of the Federal Tax Code, read together with art. 221 of the Commercial Insolvency Law

Myanmar	X	N/A	N/A	No provision	N/A	N/A
Netherlands	√ art. 21 Tax Collection Act)	No Limits	Tax claims rank after secured creditors (with the exception of certain movable assets) and before administrative expenses and labor claims (art. 21 Tax Collection Act in connection with arts. 3:284, 3:287 and 3:288 of the Civil Code).	General priority for VAT and Withholding Taxes on all goods of the debtor (art. 21 Tax Collection Act in connection with arts. 3:284, 3:287 and 3:288 of the Civil Code).	No provision	No provision
New Zealand	X	N/A	In corporate insolvency, general priorities include two priorities for withheld taxes (Schedule 7 of the Companies Act and art. 167 Tax Administration Act). These rank below administrative expenses and labor claims. The priority for the last 4 months of withheld taxes ranks at the same level as several labor claims, whereas the rest of withheld taxes rank below. In the insolvency of natural persons, the Insolvency Act (section 273) includes a general priority for all withheld taxes on workers' salaries, without limitation, and a second order priority that benefits claims for sale taxes, custom duties, and associated levies.	Withheld employee income taxes are granted priority both in corporate and natural persons' insolvency; priority for goods and services taxes, customs duties and associated levies and withholding taxes for interest and dividends are recognized a priority in the insolvency of natural persons (Section 274 Insolvency Act)	No provision	Interest for preferential claims is covered (see section 311 of the Companies Act, which refers to general rules for the calculation of interest rates - not to tax legislation)
Nicaragua	√ art. 501, Code of Civil Procedure	Limited to one year	Sixth place in the ranking, after labor claims, secured credit, and landlord's priorities, among other claims of lesser significance (art. 521 Code of Civil Procedure)	No provision	The legal provision refers to the assets to which taxes refer (art. 521 Code of Civil Procedure)	No provision
Nigeria	√ section 36 Bankruptcy Act, for individual debtors; section 657 of the Companies and Allied Matter Act, for companies)	Priority is limited to tax claims having become due within one year of commencement (Section 36 Bankruptcy Act; Section 657 - Companies and Allied Matters Act)	Taxes rank below secured credit and administrative costs and expenses. Taxes rank equally with pay-as-you-earn deductions, SS deductions, compensation due to workers etc. But these rank below administrative costs and expenses, which must be paid in priority to all other debt – (Section 657 CAMA)	These are covered within the general priority, with the same limits	No provision	No provision
Norway	√ Section 9-4, Satisfaction of Claims Act)	Multiple time limits apply (section 9-4 Satisfaction of Claims Act). As a rule, tax claims should not be overdue for more than 6 months. However, for personal income tax the deadline is two years and for corporate income tax the deadline is one year.	Ranking below secured credit, administrative expenses, and labor claims (arts. 9-2, 9-3 and 9-4 of the Satisfaction of Claims Act)	VAT and withholding tax specifically included within the general tax priority	No provision	No provision
Pakistan	√ section 405 Companies Ordinance	Time limits: only taxes that became due within one year of the commencement date	Priorities rank at the same level (section 405 Companies Ordinance)	No provision	No provision	No provision

Papua New Guinea	√ schedule 9, Companies Act	Time limits: only taxes that became due within one year of the commencement date	General priorities rank at the same level (schedule 9, Companies Act). Priorities rank below fixed charges and above floating charges.	No provision	No provision	According to section 356 of the Companies Act, penalties can be recovered in winding up. However, it is not clear whether they are covered by any priority.
Philippines	√ art. 2244 Civil Code	No limits	Special priorities take precedence over all claims (tax claims are ranked first among special priorities). For the general priority, Taxes are placed on the ninth place (national taxes) 10th (provincial taxes) and 11th (local taxes of the ranking). Other priorities than rank above the general priorities for taxes include labor claims, administrative expenses, criminal penalties, and other claims of lesser significance.	No provision	Art. 2241 Civil Code, special priority for taxes over movable assets; Art. 2242 Civil Code, special priority for taxes over real estate	Criminal penalties have a higher position than taxes. No provision for administrative penalties or interest.
Poland	√ art. 343 Bankruptcy Law	No limits	Priority of the third class, below administrative expenses, and labor claims (art. 342 Bankruptcy Act)	No provision	No provision	Interests and costs of enforcement are expressly included in the priority of the third class (art. 342.3 Bankruptcy Act) Administrative fines are subordinated (5th position in the ranking, after unsecured claims).
Russia	X	N/A	Tax claims are placed at the same level as unsecured claims, below tort claims and labor claims, and aside from secured claims (art. 134 Bankruptcy Act)	No provision	No provision	Penalties are ranked below the principal and interest (art. 137.3 Bankruptcy Law)
Rwanda	√ art. 201 Insolvency Law	No limits	Last general priority before unsecured creditors (seventh level), below secured claims, administrative expenses, labor claims, and social security contributions (art. 201 Insolvency Law)	No provision	No provision, but covered by general priority	No provision
Saudi Arabia	X	N/A	Tax claims rank below unsecured claims (Art. 197 h, Bankruptcy Law)	No provision	N/A	N/A
Singapore	√ s. 203 Insolvency Act	No limits	Last priority before unsecured creditors (section 203 (1) (i) Insolvency Act)	No provision	No provision, but covered by general priority	No provision
South Africa	√ s. 101 Insolvency Act	No limits	General priority after specific security interests, administrative expenses, and labor claims. Ranking before general mortgage bonds (sections 95-102 Insolvency Act)	Withholding taxes, customs, excise, VAT, and sales tax rank with certain labor claims, ahead of income and profit taxes (s. 99, Insolvency Act)	No provision, but covered by general priority	Interest and penalties are covered by priorities
Spain	√ art. 280.4 Insolvency Law	Priority of tax claims under the general priority of art. 280.4 of the Insolvency Law is limited to 50% of the amounts owed. Remainder treated as general unsecured debt	Withheld taxes only rank below labor claims. The rest of the taxes, with the 50 percent limit, are at the fourth level of general priorities, below claims for personal work and intellectual property rights. General priorities rank below special priorities (which	Withheld taxes have a general priority of higher ranking than tax claims (art. 280.2 Insolvency Law) and are not subject to the 50 percent limit that applies to the other tax liabilities.	There are special priorities that provide preference over the asset, similar to security interests. These affect real estate taxes, for one year (art. 78 General Tax Law), and for taxes that refer to specific assets (art. 79 of the General Tax Law)	Interest and penalties are subordinated claims (arts. 281.3. and 4 Insolvency act)

			include secured credit) and costs and expenses of the procedure.			
Sri Lanka	√ Sch. 9, Companies Act	Time limits: one year for income tax (year to be selected by tax authority); one year for turnover tax, four periods for VAT (to be selected by the tax authority); other taxes due and payable within the 12 months before commencement	All tax priorities are included among general priorities, which rank between fixed charges and floating charges (Sch. 9 Companies Act)	No special provision, included in general priority.	No provision	No provision
Sweden	X	N/A	N/A	N/A	N/A	Fines are subordinated (section 19, Priority Rights Act).
Switzerland	X	N/A	N/A	N/A	N/A	No provision
Tajikistan	√ art. 78.4 Insolvency Law	No limits	Last general priority before unsecured creditors, and after tort claims, labor claims and secured claims (art. 78 Insolvency Law)	No special provision, included in general priority.	No provision	No provision
Tanzania	√ section 367 Companies Act	Time limits: tax claims must have become due within 12 months of commencement	General priorities rank all at the same level, after fixed charges and before floating changes	No special provision, included in general priority.	No provision	No provision
Thailand	√ section 130 Bankruptcy Act	Priority of tax claims limited to tax claims due within 6 months prior to the commencement of bankruptcy proceedings, after payment of secured claims and costs of administering the proceedings. Any balance is treated as a general unsecured claim.	Sixth general priority, at the same level as labor claims (section 130 Bankruptcy Act).	No special provision, included in general priority.	No provision	No provision
Türkiye	√ Art. 206 of the Enforcement and Insolvency Law refers to priorities in special laws (priority in the fourth ranking); and art. 21.3 of the Law on the collection of public receivables establishes the general priority.	No limits	Last priority before unsecured creditors (section 203 (1) (i) Insolvency Act)	No special provision, included in general priority.	No provision	No provision
UK	X		VAT and other withheld taxes are included among general priorities as a secondary priority (Section 386 of the Insolvency Act, as modified by Section 98 and 99 of the Finance Act 2020; Sch. 6 of the Insolvency Act; see also Insolvency Act Regulations 2020). Order of priority - secured creditors; insolvency practitioner fees and expenses; preferential creditors; secondary preferential creditors; floating	VAT and withheld taxes are the only tax claims that benefit from a general priority, without limits	No provision	No provision

			charge creditors; prescribed part creditors (carve -out from floating charges); unsecured creditors;			
United Arab Emirates	√ art. 42 Bankruptcy Act	No time limits	Last general priority before unsecured creditors	No provision	No provision	No provision
USA	√ section 507 Bankruptcy Code	Time limits: Income or gross receipts tax - 3 years; property tax - 1 year; withholding taxes - no time limit; employment tax on wages, salaries, commissions - 3 years; excise tax - 3 years; customs duties - 1 year (Section 507(a)(8) Bankruptcy Code)	Tax claims rank eighth ranking after administrative expenses, labor claims, and other claims of lesser significance (Section 507(a)(8) Bankruptcy Code). In addition, all priorities rank below secured claims and expenses.	Withholding taxes are granted a general priority	No provision, but covered by general priority	No provision
Venezuela	√ art. 68 Organic Tax Code	No time limits	Third priority, above secured creditors, and below expenses, labor claims	No provision, but included in the priority	No provision, but covered by general priority	Interest and penalties covered by the priority (art. 68 Organic Tax Code)
Vietnam	X	N/A	Tax claims rank at the same level as unsecured claims (art. 54 of the Bankruptcy Law)	N/A	N/A	N/A

Annex II. Tax Collection in Insolvency in Spain

	2018 (€)		2019 (€)
Income from insolvency proceedings (not finished)		Income from insolvency proceedings (not finished)	
Voluntary payment	156.750.348,25	Voluntary payment	157.466.157,88
Forced payment	**203.912.503,92**	Forced payment	**152.598.108,04**
Total	360.662.852,17	Total	310.064.265,92
Income from insolvency proceedings (finished in 2018)		Income from insolvency proceedings (finished in 2019)	
Voluntary payment	10.865.343,44	Voluntary payment	4.502.315,11
Forced payment	**14.195.549,44**	Forced payment	**9.594.788,01**
Total	25.060.892,88	Total	14.097.103,12
Grand total	385.723.745,05	Grand total	324.161.369,04

Total insolvency enforcement 2018: 218.108.052

Total insolvency enforcement 2019: 162.192.896

Total tax income 2018: 208,685,000,000

Total tax income 2019: 212,808,000,000

Source: Spanish Tax Administration (AEAT). All figures are in euros.

Annex III. Countries that have Eliminated or Reduced Tax Priorities

NB.- This is a non-exhaustive list of countries that have eliminated or reduced tax priorities, with the year of adoption of their insolvency law.

- Denmark (1969)
- Australia (1979 and 1993)
- Austria (1982)
- UK (1986 and 2002)[1] -
- Iceland (1991)
- Finland (1992)
- Canada (1992)
- Russia (1992)
- New Zealand (1993)
- Germany (1994)
- Switzerland (1996)
- Estonia (1996)
- Croatia (1996)
- Kyrgyz Republic (1997)
- Korea (1998)
- Spain (2003) -
- Portugal (1993 and 2004)
- Sweden (2004)
- Slovakia (2005)
- Vietnam (2014)
- Kenya (2015)
- India (2016)
- Jordan (2018)
- Saudi Arabia (2018)
- Myanmar (2020)

[1] Some priorities for certain taxes have been reintroduced in 2020.

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