



The escalating problem of tax arrears

The summer is now well and truly over and the economic realities may be coming home to over 200,000 UK businesses. Since November 2008 HM Revenue & Customs (HMRC) has agreed some 204,000 time-to-pay arrangements following the launch of the Business Payment Support Service (BPSS) late last year.

Under the terms of those agreements some £2.7bn has already been deferred as of June this year and £1.1bn of that now needs to be repaid and of that figure, according to the Treasury, 33,000 repeat arrangements account for £440m.

This initiative has provided immense support to distressed businesses but this could have stored up disaster for certain businesses, as deferring payments to HMRC does not mean the debt has gone away nor perhaps underlying business issues and lenders need to be aware of this.

When there are cashflow difficulties, VAT and PAYE/NI obligations are all too often missed in favour of those more pressing such as wages, supplier payments and rent which have the potential to threaten a business if they are not made. Whilst the intention may well be to catch up with the unpaid tax at a later date, however, when a business faces continued cashflow and/or trading difficulties, the opportunity to do so may not necessarily present itself.

Lenders need to appreciate that because HMRC are tax collectors rather than a commercial source of finance, once all reasonable steps in debt recovery, which includes time to pay, have been exhausted then they have an obligation to instruct bailiffs and/or commence winding up actions.

Working with the taxman

HMRC stress the need to make contact before tax payments become overdue, not after – when the debt collection process has already swung into action and surcharges, penalties and interest have been applied.

Detailed long-term assessment on management's strategy, access to funding, cashflow and the viability of the business itself are critical. In the short term if businesses can put their house in order with expert advice and guidance from MCR, the chances of survival in these tough economic conditions will greatly improve.

This does not negate the importance of understanding the many reasons why tax arrears may build up in a normal economic climate – and what action should be taken.

Why tax arrears arise

With hindsight, it is often easy to pinpoint how and why tax arrears have arisen, and the easily resolved tax disputes, which can include the following:

- errors in calculation;
- incorrect use of VAT schemes;
- delays in obtaining VAT registration and/or tax clearance for new businesses;
- inadequate accounting systems and procedures; and
- lack of accurate advice from external advisors.

It becomes substantially more serious if there is not enough cash to pay off the arrears immediately. In this case, it is highly likely that the business has liquidity problems caused by internal or external factors that have given rise to the tax issues.

ABL visibility

MCR itself can identify and work with ABLs to continually assess a number of internal/external factors that can lead to problems in trading. These include:

- problem industries or sectors;
- over-trading;
- inefficient internal controls including systems and procedures;
- undercapitalisation and/or underinvestment;
- inappropriate funding structure;
- inexperience within the management team or lack of one;
- untimely, inaccurate and/or unreliable management information;
- high turnover of staff/key personnel;
- lack of planning on major strategies such as acquisitions, diversification, expansion and relocations;
- significant external one-off event e.g. bad debt, fire or loss of key staff;
- loss of confidence from funder(s) and withdrawal of facilities;
- loss of credit insurance; and
- internal fraud or theft.

If the box can be ticked on one or more of these it is highly likely that more analysis and investigation is required and this is where MCR can bring real value to the ABL. Any of these factors have the ability to impact on a company and its ongoing trading capabilities and ultimately that company's continued funding requirements. The pressure of overdue payments to suppliers and HMRC requires expert turnaround help in managing cashflow, raising new finance and securing payment plans with all creditors, including the taxman.

Putting a strong case forward

It is worth noting that HMRC will not view their indebtedness in the same commercial context, nor are they obliged to. Any concession given must be considered by a business to be exceptional and not be taken for granted.

When MCR acts on behalf of a lender our role is to work with HMRC and ultimately lay out the repayment proposals in the form of a report which will comprise a business overview, commentary on recent trading performance, demonstrate what corrective actions have been taken and support the viability of the business with reference to long-term projections. Importantly, we need to demonstrate that all reasonable steps have been taken and that HMRC have not been used solely as an alternative form of commercial finance, which is clearly not its role.

If a time-to-pay deal is agreed, it is critical that a business sticks to the arrangement, as there are serious implications for defaulters. The existence of failed arrangements in the past implies that they were either flawed or unrealistic.

It is crucial that early engagement takes place with all parties involved, including lenders, so that potential solutions can be reviewed as early as possible.

That means that lenders and business owners need to be aware that even with the introduction of deferred tax payments, all tax liabilities will still need to be paid albeit over a longer and more manageable timescale. However lenders should be assessing their portfolios to ensure that there are no further ticking time bombs because ultimately time-to-pay arrangements have simply done just that, they have not necessarily solved the underlying business issues that still need to buy time.



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