Rescuing a business from insolvency: gaining more time to pay your debts

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We examine the primary legal mechanisms businesses can use to gain more time to pay debts, and how to can secure the best payment terms when negotiating with HMRC.

Key Points

What is the issue?

There are several ways that a business can approach financial difficulties. The two primary mechanisms are Time to Pay Arrangements for debts to HMRC; and Company Voluntary Arrangements for debts to other creditors.

What does it mean for me?

Securing a formal agreement with new payment terms has significant additional advantages, making it easier for the business to move into a better financial position, but also taking off the pressure from creditors and the threat of legal action.

What can I take away?

The company reacts, and the more proactively it pursues a resolution to the challenges of insolvency, the more options will be available and the better the organisation's chances of making a proper recovery.

There are several routes to rescue an insolvent company, but to give a business the best possible chance of recovery, securing more time to pay debts is typically crucial. Whether this will require the business to reform the way it manages cash flow, restructure its operations or secure outside financing, gaining more time to pay the money it owes offers the necessary breathing room the organisation can use to implement these changes.

Securing a formal agreement with new payment terms has significant additional advantages – not only making it easier for the business to pay its debts and move into a better financial position, but also taking off the pressure from creditors and the threat of legal action. If the matter has already been brought to the courts, businesses can make formal arrangements with their creditors that will set new payment terms and bring any legal action to an immediate halt.

The approach a business should take in these circumstances will differ depending on the nature of its creditor. Debts to HMRC are treated differently from debts to suppliers or other creditors. But the sooner the company reacts, and the more proactively it pursues a resolution to the challenges of insolvency, the more options will be available and the better the organisation's chances of recovery.

Ways to secure new payment terms

There are several ways that a business can approach financial difficulties, but the most important consideration is to be proactive and address concerns as early as possible. It should be clear to most business owners that their organisations are at risk of insolvency, and it is best to be cautious. If the ability to pay debts when they fall due relies on a single large payment from a customer, or an order that is expected but which has not yet been confirmed, the business should proceed on the assumption that this will not take place.

This is the only way to ensure that there are appropriate contingencies in place and means that the business can start to address the debt challenges before they become much more urgent – and before options begin to fall away. By taking proactive steps and communicating with their creditors, businesses will have a better chance of maintaining a positive relationship. This could be vital, as any efforts to secure more time – whether through the available legal mechanisms or simply by negotiating new payment terms – will rely on support (and, in some cases, approval) from creditors before these can proceed. This also means that, if the company successfully pays off its debt and recovers from the threat of insolvency, it can continue its business relationship with the creditor.

The cash flow challenges that can prevent businesses from paying their debts on time will come and go – it is rarely about the relationship that an organisation has with a single creditor, even if that creditor's strict payment terms or forceful efforts to pursue its debts are part of the problem in the current circumstances.

While informal negotiations with creditors may result in new payment terms, it is typically best to secure a formal agreement for a new payment plan that allows the debtor to pay the money they owe over time. This is especially important where there is more than one creditor, as a structured agreement has a number of benefits. Two primary mechanisms enable this: Company Voluntary Arrangements for debts to general creditors and Time to Pay Arrangements for debts to HMRC.

Company Voluntary Arrangements

A Company Voluntary Arrangement is a legally binding agreement between a company and a creditor that offers a structured payment strategy. It allows the business to pay its debts in set instalments over an agreed period of time, which can make them much more manageable from the perspective of the debtor, and ensure that creditors receive the full amount (or an agreed percentage) of the money they are owed.

The company must make a proposal for a Company Voluntary Arrangement and present it to creditors, who are given an opportunity to approve or reject the proposal. There are strong incentives for the creditors to vote to approve the Company Voluntary Arrangement, provided the proposal is fair, reasonable and realistic. A suitable Company Voluntary Arrangement will often give creditors the best possible chance of recovering their debt, because other legal mechanisms – for example, applying to wind up the debtor's business and force it into liquidation – will only result in a partial dividend for the creditor, which may not cover the full debt amount.

Businesses can only pursue a Company Voluntary Arrangement through an insolvency practitioner, who will work out an ‘arrangement’ covering the amount of debt that the business can pay and a payment schedule. They must do this within a month of being appointed. Businesses can find a licensed insolvency practitioner in their area via the Insolvency Service at: www.gov.uk/find-an-insolvency-practitioner.

Insolvency practitioners can also manage the process of gathering creditors to vote on the proposal and ensure that the payment plan is fair to all parties involved. Once the proposal is complete, the insolvency practitioner will send it to creditors for consideration. After 14 days, they are asked to vote and the Company Voluntary Arrangement is approved if 75% (by debt value) of the creditors who vote agree. If approved, then all unsecured creditors are bound by the arrangement. At this point, any legal actions against your company are halted and your creditors cannot take any further action against you if you keep to the terms of the Company Voluntary Arrangement.

A Company Voluntary Arrangement can provide breathing space for companies in debt. It stops legal action by creditors and can even write off a portion of the debt if it is deemed unmanageable. Importantly, it allows the company to continue trading throughout the process, which can preserve jobs and potentially lead to a recovery in business performance, which is the best-case scenario for a business facing the threat of insolvency.

A Company Voluntary Arrangement may enable a company to avoid the negativity of other insolvency procedures. The arrangement is not normally advertised but is registered at Companies House and employees must be informed.

However, it is worth noting that a Company Voluntary Arrangement can negatively impact a company’s credit rating, making borrowing more expensive in the future. It also requires strong management commitment to successfully navigate through the repayment period and implement necessary operational changes. This is just one reason that it is important to seek expert advice when your business is facing insolvency and to plan your approach carefully.

Working with HMRC on Time to Pay Arrangements

A Time to Pay Arrangement is an arrangement set up by HMRC to cover debts owed to HMRC. A Time to Pay Arrangement can cover all outstanding amounts overdue, including penalties and interest. HMRC has set out details at tinyurl.com/2cj5mzxd, including the new facility for an individual with a self assessment tax debt not exceeding £30,000 to make an application online. There is a fuller discussion of Time to Pay Arrangements in ‘Avoiding enforcement action due to tax debt’ in the March 2022 issue of *Tax Adviser*.

Interest will accrue from the due date to the end of the Time to Pay Arrangement, and the interest payable will be included in overall debt covered by the arrangement. The current interest rates applied to the main taxes and duties that HMRC currently charges and pays interest on are:

- late payment interest rate: 7%; and
- repayment interest rate: 3.5%.

The Time to Pay Arrangement allows businesses to pay their tax debts over a set period of time; when making a proposal, the business must demonstrate that the proposed payment plan is feasible and that future tax obligations will be met on time. Unlike the CVA, the Time to Pay does not normally write off part of the tax debt.

The length of the arrangement will depend on how much the business owes and its financial circumstances. HMRC can request a range of information when working on the arrangement, including information about the business's financial position and how its finances are expected to change in the future. HMRC will ask what efforts have been made to raise the funds against the business' debt and to try to pay the tax bill, and what the business is doing to get its tax affairs back on track. It may also discuss whether there are business assets that can be released to reduce the debt as much as possible before agreeing an arrangement.

Provided the business puts forward a fair and reasonable payment plan which will pay off the debt as quickly as possible, HMRC has an incentive to grant a Time to Pay Arrangement. A formal agreement of this nature will also set an expected payment schedule and give HMRC the best chance of recovering all of the money owed. If the business fails to comply with the approved proposal, HMRC can still pursue legal action. Recent changes to the law have made HMRC a higher-priority creditor, which makes it easier for the tax authority to recover debts it is owed by insolvent businesses.

The change, which was introduced by the UK government in 2020, elevated HMRC to the position of a secondary preferential creditor and established that certain tax debts are secondary preferential debts, ringfencing these funds for HMRC. This ensures that any taxes that are due but are held by a company when it goes into liquidation – including VAT, Pay as You Earn (PAYE) Income Tax and National Insurance contributions for employees, among others – are paid to HMRC, ahead of any secured creditors with a floating charge, and any non-preferential creditors.

With these changes, HMRC is now better able to secure the money it is due. As such, it is vital to ensure that any proposal for a Time to Pay Arrangement is prepared with a thorough understanding of the financial position of the business in question. The most important priority to successfully securing new payment terms with HMRC is to make the proposal as attractive as possible, as well as ensuring that it is realistic and possible to achieve. If a business fails to meet the new payment terms, the consequences can be severe – this means that striking a balance of fairness between all parties is of the utmost importance to a Time to Pay proposal.