DUFF & PHELPS

VAT/PAYE Bonds: ABLs beware the flaming tail of a phoenix!

As Greek mythology has it, a phoenix is a long-lived bird that is reborn from the ashes of its predecessor. And so it is in the world of corporate recovery, with many businesses emulating this mythical transition with a new company reborn when the old one dies.

Historically, HM Revenue & Customs has suffered many significant write-offs when a company becomes insolvent. HMRC Specialist Investigations has started targeting phoenixes by imposing VAT bonds and, since 2012, PAYE bonds to protect against future write-offs. HMRC will also target poorly compliant businesses and high-risk sectors, such as temporary recruitment, where VAT and PAYE/NI obligations are disproportionately high compared with other creditors by searching for common directors/shareholders, family connections and also trading locations.

How do bonds affect an ABL?

A newco's cash position can be very constrained given a likely loss of trade credit and inheriting costs such as wages and ransom payments from its predecessor to ensure continuity of trade and supply. Unfortunately, demands usually arise several months after a newco starts trading and, in our experience, very few companies are prepared.

If an ABL is the principal funder, they are a natural first port of call to help meet the funding requirement. Whilst Duff & Phelps can help to mitigate demands, it often means that an ABL is requested to fund at a higher level

Typically, a VAT bond comprises six months of VAT and is held for a year, during which time a company will need to file monthly VAT returns and pay on time. PAYE bonds are assessed on a case-by-case basis.

A tale of two bonds.....

First offence – luxury goods distributor

A long-established distributor of luxury goods was placed into administration following a downturn in trade, combined with an unexpected reduction in bank facilities and a loss of trade credit. The company's two directors at the time were married, but business stresses led to their separation. The ex-husband bought the business back in August 2013 and, four months later, he received a VAT bond demand for £125,000.

The ABL faced a difficult decision – should they provide a long-term overpayment or withdraw funding altogether? The ABL referred the director to Duff & Phelps and we were engaged in December 2013.

After demonstrating the genuine circumstances surrounding the insolvency and how the directors introduced and lost personal monies just prior to the event, HMRC agreed to waive the bond subject to newco filing monthly VAT returns going forward. This case study illustrates that HMRC is sympathetic to a well-reasoned appeal. At the same time, the ABL funder retained a client and the company was able to continue trading.

Repeat serial offender – temporary recruitment business

Our concerns were raised when Mr X revealed in our initial meeting that he was not a director of the company. Instead, the sole director was his friend, Mr Y, a man who had no experience in the recruitment sector. After this meeting, we identified that Mr X had been involved in at least three administrations in the last five years, with HMRC suffering a loss each time.

In this meeting, we learned that newco had traded for two years without any major issues albeit margins were tight and recruitment process outsourcing organisations meant margins were squeezed further. However, the company had paid its HMRC obligations late in the last few months. It was also revealed that Mr Y did not understand the significance of a registered office address – which, in this case, was his matrimonial home – or keeping it current. Consequently, when he separated from his wife and moved out, he did not know that HMRC had served winding up papers over a debt of £50,000 until it was advertised in The Gazette.

Whilst this debt was subsequently paid with the help of the ABL and a validation order, the time taken was such that wages were paid late. The late payment of wages is a cardinal sin for recruitment businesses and, in response, certain customers began to reserve heavily against payments whilst others withdrew business altogether. What started off as a £50,000 HMRC underpayment, in August 2013, quickly spiralled into VAT/PAYE debts of £250,000 by November 2013.

To make matters worse for Mr X, these events allowed HMRC to establish a connection with the company and his prior insolvencies and demands for VAT and PAYE/NI bonds followed in November 2013 for £500,000 and £75,000 respectively – £575,000 in total. The total VAT/PAYE bill at the time of our meeting was £825,000 which clearly challenged the company's survival.

Action points

- Carefully review potential director candidates, especially those with multiple insolvencies.
- Ensure there is a contingency plan for bonds or fund at a lower level.
- Query registered office addresses that do not belong to the company or its auditors.
- Don't let monthly MI slip and obtain evidence that HMRC is paid in full.
- Bonds are serious – ignoring it whilst trading on is a criminal offence and directors could face further action by the CPS.

Mike Lee, Senior Manager,
Tax Arrears Solutions, Duff & Phelps
tel: +44 (0) 161 827 9159
e-mail: mike.lee@duffandphelps.com