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LAW LLP

HMRC HAS PRESENTED A WINDING-UP PETITION?

5 CRITICAL THINGS DIRECTORS NEED
TO KNOW BEFORE IT IS TOO LATE

A practical guide to the Part A1 moratorium, business rescue
and avoiding compulsory liquidation

INTRODUCTION

Receiving a winding-up petition from HMRC is one of the most serious challenges a company can face.

Receiving a winding-up petition from HM Revenue & Customs ("HMRC") is one of the most serious challenges a company can face. Many directors assume that, once a petition has been presented, compulsory liquidation is inevitable. That is not necessarily the case.

Over the years, Summit Law has advised directors and companies facing HMRC enforcement action, including compulsory liquidation proceedings and insolvency investigations. A common mistake is delaying specialist assistance because directors believe that no rescue options remain.



HM REVENUE & CUSTOMS

For an eligible company, however, a Moratorium under Part A1 of the Insolvency Act 1986 provides a temporary "breathing space" in which to explore refinancing, restructuring or other rescue options free from creditor action.

Where a winding-up petition has been presented, the company can apply to the court for a Moratorium and there is no requirement to notify creditors generally (as there is with other insolvency procedures).

Some commentators have described the Moratorium as a "light touch" Administration but it is important to appreciate that it is neither an Administration nor a Liquidation; rather, it uniquely allows a company a short period in which to achieve its rescue as a going concern, free from creditor pressure.

This guide explains five key issues directors should understand when considering whether a Part A1 Moratorium could assist them in rescuing the business and ensuring continuance of trade.

Do Not Assume a Winding-Up Petition Means the End of the Road

Many directors mistakenly believe that, once HMRC presents a winding-up petition, the company has no option other than liquidation.

Although an eligible company subject to an outstanding winding-up petition cannot use the ordinary out-of-court filing procedure to obtain a Moratorium, it nevertheless may apply to the court for an order commencing one.

Presentation of a petition therefore does not automatically eliminate every rescue option. Depending on the circumstances, the company may still be able to pursue a Moratorium, which may involve refinancing or new investment or an agreement with HMRC and other creditors, or, in more complicated cases, progressing a company voluntary arrangement, a restructuring plan or Administration. The suitability of each option will depend on the company's eligibility, financial position and prospects.

Why This Matters

Valuable time can be lost if directors begin winding down operations (or simply go straight for an Administration) without first assessing the alternative of a Moratorium. Employees may leave, suppliers may withdraw credit, customers may lose confidence, and the value of the business may deteriorate quickly.

Timing is particularly important because advertisement of a winding-up petition may cause banks to freeze or restrict the company's accounts. It can also alert other creditors, damage commercial relationships and make rescue funding more difficult to obtain.

A Moratorium does not extinguish the petition debt or automatically dismiss the petition. However, it will prevent the petition from progressing to a winding-up order while the Moratorium remains in force, subject to the statutory provisions and any relevant court orders. Unless the debt and petition are resolved, the proceedings may continue after the Moratorium ends.

PRACTICAL TIP

If the company receives a winding-up petition, obtain insolvency and restructuring assistance immediately. Directors should promptly establish whether the petition has been advertised, the date of the hearing, whether the company's bank accounts have been restricted, the amount owed to HMRC and other creditors, and whether the petition debt is admitted or genuinely disputed.

The earlier those matters are assessed, the greater the opportunity to preserve value and formulate a credible rescue strategy.

Understand that a Moratorium Is Not Automatic

Where a winding-up petition is outstanding, the court must be satisfied that the Moratorium would achieve a better result for the company's creditors as a whole than would be likely if the company were wound up without first being subject to the Moratorium.

To assist the court, the legislation provides that a statutory opinion must be obtained from a licensed insolvency practitioner who consents to act as a "Monitor" in relation to the proposed Moratorium. The proposed Monitor must consent to act and provide the statements and opinion required under Schedule ZA1 to the Insolvency Act 1986, including the relevant opinion concerning the likelihood of rescuing the company as a going concern.

So although a company is not entitled to a Moratorium merely because it needs additional time to pay a debt, the procedure can be used to achieve that goal so long as it is likely that the Moratorium would result in the rescue of the company as a going concern.

Why This Matters

The court will not grant a Moratorium simply because the directors hope that the company's position will improve. The application must be supported by credible evidence explaining what is expected to happen during the Moratorium, how the company is to be rescued as a going concern, how the company will meet the liabilities that remain payable and why the proposed Moratorium would produce a better result for creditors as a whole than the winding-up alternative.

The statutory test refers to a "better result", rather than only a higher financial dividend. Financial outcome will ordinarily be central, but continued trading, preservation of enterprise value and employee retention may also be relevant where they contribute to improving the position of creditors as a whole.

PRACTICAL TIP

Before making an application, directors should assemble reliable financial and commercial evidence. This will ordinarily include current and projected cash flow, trading performance, asset values, the causes of the company's financial difficulties, refinancing or investment proposals and the estimated outcome for creditors under the available alternatives.

Forecasts should be realistic, evidence-based and stress-tested. Unsupported assumptions or speculative funding proposals are unlikely to provide a proper foundation for a court application.

Have a Genuine Rescue Plan, Not Just Optimism

The decision in a leading case (*Re Grove Independent School Ltd*) illustrates that the court will examine the commercial reality of the proposed rescue. The outcome in that case depended on its particular evidence and circumstances, including the company's asset position and refinancing proposals.

A Moratorium is intended to facilitate the rescue of the company itself as a going concern. It is not intended merely to delay an inevitable liquidation or provide time to dispose of the company's business without a credible plan to rescue the company.

Why This Matters

A speculative proposal, or an unsupported hope that matters will improve, is unlikely to satisfy the statutory requirements. Directors must be able to explain what rescue steps will be taken, who will undertake them, when they will occur, how the company will be funded during the process and why the proposal has a realistic prospect of succeeding.

The initial Moratorium ordinarily lasts for only 20 business days. Although an extension is not automatic, the Moratorium can be extended through a variety of routes including, depending on the circumstances, a directors' extension, creditor consent or a court order.

The rescue plan must therefore be capable of meaningful implementation within a compressed timetable.

PRACTICAL TIP

Directors should prepare a written rescue plan and implementation timetable before applying to court. The plan should address immediate stabilisation, cash requirements, negotiations with HMRC and other key creditors, the source and timing of proposed finance, any conditions attached to that funding and the alternative strategy if the principal proposal cannot be completed.

Any expression of interest from a lender or investor should be documented. Significant funding conditions, due diligence requirements and uncertainties should be identified rather than presented as settled commitments.

Understand the Limits of Moratorium Protection

A Moratorium provides important and immediate protection, but it is not a complete payment holiday and does not remove every legal or commercial risk.

During a Moratorium, restrictions generally apply in relation to winding-up proceedings, enforcement of security, repossession of goods, lease forfeiture and the commencement or continuation of legal proceedings. Those protections are subject to statutory exceptions and, in some cases, court permission.

The company must also continue paying specified liabilities. Broadly, these include liabilities arising during the Moratorium, payment for goods and services supplied during it, rent attributable to the Moratorium period, wages and salary, the Monitor's remuneration and expenses, and certain financial-services liabilities.

Clearly, a company that cannot meet the liabilities required to be paid during the Moratorium may not be suitable for the procedure. The Monitor must keep the company's position under review and may be required to seek a termination of the Moratorium if the statutory conditions cease to be satisfied.

Why This Matters

Directors must not assume that a Moratorium permits the company to stop paying all creditors or to continue trading without adequate working capital.

Directors must also consider section 127 Insolvency Act 1986. If the company is ultimately wound up on the existing petition, dispositions of company property made after presentation of the petition may be void unless the court orders otherwise. This can affect bank payments, asset sales, new security, payments to connected parties and transactions undertaken in the ordinary course of business.

Therefore, a validation order may be required to protect particular post-petition transactions.

PRACTICAL TIP

Before making significant payments, selling assets, granting security or entering material transactions after presentation of the petition, directors should assess the effect of section 127 and whether a validation order is required.

The proposed transaction should also be considered in the context of the rescue or refinancing involved, the interests of creditors as a whole, the company's working-capital requirements and any need for the Monitor's consent.

Engage an Insolvency Practitioner Early

A Moratorium requires a qualified insolvency practitioner to act as the Monitor.

The proposed Monitor must consent to act and provide the statutory statement and opinion required to support the application. The Monitor must exercise independent professional judgment and cannot simply adopt the directors' preferred outcome.

The directors ordinarily remain responsible for managing the company during the Moratorium, subject to statutory restrictions and the Monitor's oversight. The Monitor must keep the company's position under review and may be required to terminate the Moratorium if rescue of the company as a going concern is no longer likely, the objective has been achieved, the company cannot pay liabilities that must be paid, or the directors fail to provide required information.

Why This Matters

A Moratorium cannot be obtained without an eligible proposed Monitor who is prepared to consent to act and provide the requisite statutory opinion.

Approaching an insolvency practitioner immediately before the petition hearing may leave insufficient time to verify the financial information, investigate refinancing proposals, prepare cash-flow forecasts, compare creditor outcomes and complete the application to court.

The company must also be eligible for the procedure. Schedule ZA1 Insolvency Act 1986 contains exclusions and restrictions, including provisions affecting certain financial-services companies and companies recently subject to specified insolvency procedures.

PRACTICAL TIP

Directors should engage legal and insolvency professionals as soon as serious financial difficulties arise. Early engagement allows sufficient time to assess eligibility, determine whether the Monitor can properly give the required opinion, confirm that the company can fund the Moratorium and prepare the evidence needed for a court application.

What Does the Grove Decision Mean for Directors Facing HMRC Action?

Re Grove Independent School Ltd also confirms that an existing HMRC winding-up petition does not create an absolute bar to a court-ordered Moratorium. Indeed, that may be the very circumstance in which a Moratorium is most attractive to directors.

The decision is nevertheless fact-specific. It should not be understood as establishing that a Moratorium will always be granted whenever a company has substantial assets, possible lender support or prospective refinancing.

However, for a suitable company, a Moratorium may provide temporary breathing space to negotiate with creditors, obtain refinancing or investment, preserve enterprise value and implement a restructuring proposal. It may also restrict certain enforcement action while the company seeks to achieve a better result for creditors as a whole.

The proposed Monitor must be able to provide the required statutory opinion. The court must separately be satisfied that the Moratorium would achieve a better result for creditors as a whole than would be likely if the company were wound up without first entering the Moratorium.

Directors' Duties Remain Important

A Moratorium does not suspend the directors' statutory and fiduciary duties.

Where a company is insolvent, or insolvent Liquidation or Administration is probable, the interests of creditors assume particular importance. Directors should ensure that decisions to continue trading, incur further liabilities or dispose of assets are properly considered and documented.

Potential claims (if a Liquidation or Administration follows) may include wrongful trading, transactions at an undervalue, preferences, transactions defrauding creditors and misfeasance. Those claims do not arise automatically because a company enters insolvency, but directors should maintain a clear written record of the financial information considered, the alternatives assessed, the expected effect on creditors and the reasons for continuing to trade.

A credible Moratorium proposal should be consistent with, rather than a substitute for, the proper discharge of directors' duties.

It Is Time to Take Action

If HMRC has threatened a winding-up petition or has already presented one against the company, urgent action is required.

At Summit Law, we regularly advise directors, shareholders and businesses facing HMRC enforcement action, winding-up petitions, insolvency proceedings and business rescue situations.

We can assist with:

- Assessing whether a Moratorium is available and appropriate
- Evaluating restructuring and rescue options
- Preparing the evidence required for a court application
- Negotiating with HMRC and other creditors
- Advising on section 127 and validation orders
- Addressing threatened or actual claims concerning directors' conduct

The appropriate strategy will depend on the company's financial position, eligibility, available funding and the stage reached in the winding-up proceedings.

Book a Free Initial HMRC Petition Strategy Call

If the company is facing HMRC enforcement action or has received a winding-up petition, contact Summit Law promptly to discuss the available options.

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The information provided in this document does not, and is not intended to constitute legal advice. Instead, all information is for general informational purposes only. Should you wish to obtain legal advice in relation to the matters raised, please do not hesitate to contact us.

About the Author



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Jeremy Boyle is an insolvency solicitor who advises directors, companies, insolvency practitioners and other stakeholders on business rescue, insolvency litigation and director liability matters.

His experience acting for insolvency practitioners informs his work advising directors and companies on potential claims, insolvency risk and the steps available when financial distress arises. This enables him to identify issues at an early stage, assess the strength of threatened claims and assist directors in making informed decisions.

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