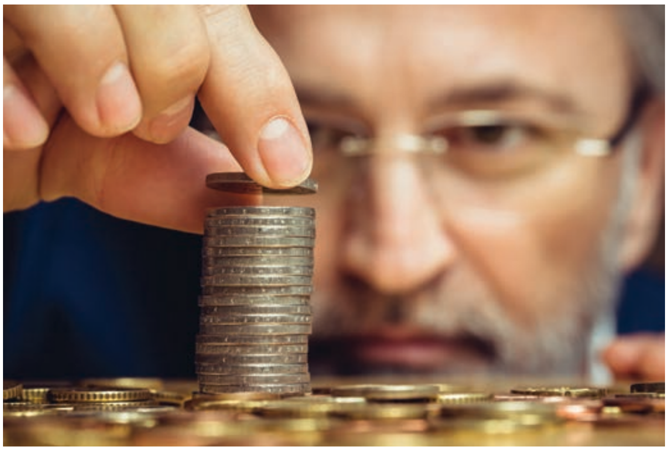
Coronavirus and cash management

The coronavirus has brought cash management and liquidity problems. Stuart Pibworth and Jenny Doak emphasise the importance of taking taxes into account when considering the options.



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Businesses are facing unprecedented levels of operational disruption with new challenges emerging daily. One of the key challenges is cash management and liquidity, but an important question is how we factor taxes into this. When considering the various measures introduced, some key tax considerations have emerged.

Coronavirus job retention scheme

Although much of the commentary on the coronavirus job retention scheme (CJRS) has focused (understandably) on grants for employee salaries, it should not be forgotten that employers are also eligible to be reimbursed for the employer's National Insurance contributions and the minimum auto-enrolment employer pension contributions attributable to the pay covered by CJRS. Note, however, that CJRS does not cover apprenticeship levy contributions.

Grants under CJRS are separate from normal payroll processes in that employers are still required to deduct income tax and employee's National Insurance under PAYE as normal, and remain liable for employer National Insurance and pension contributions on employee pay. CJRS is solely a mechanic to reimburse the employer for the covered costs.

Employers should recognise any CJRS grants as taxable income, but employment costs are deductible in the normal way so that CJRS grants should be tax neutral for employers.

Key points

- Basic principles of the coronavirus job retention scheme.
- VAT payments due between 20 March and 30 June 2020 can be deferred.
- There has been no general automatic deferral of all business taxes (such as payroll or corporation taxes).
- Managing debt and ongoing liquidity.
- If renegotiation is not possible can the business debts be refinanced?
- Liquidity and cash management strategies could mitigate tax leakage.

VAT payment deferral

VAT payments due between 20 March and 30 June 2020 can be deferred and, instead, paid by the end of the current tax year. No notification of a deferral is required (albeit it is not obligatory) and no interest and penalties will be payable on the deferred amount. Some practical points are worth noting.

- Companies wishing to defer should remember to cancel any VAT direct debits during the deferral period.
- This is only a deferral and not a waiver of the VAT and should be reflected accordingly for forecasting purposes.
- Although the VAT payment is deferred, VAT returns must still be filed as normal.
- The VAT deferral does not apply currently for payment for VAT mini one-stop shop or import VAT (except for vital medical supplies).
- Financing documents should be reviewed to ensure deferral does not trigger any breach of representations or undertakings.

Income tax self assessment

Similarly, self-employed individuals (including partners in partnerships) who account for income taxes through payments on account can defer their income tax payment on account that would have been due by 31 July 2020 until January 2021. Again, there is no need to notify HMRC if individuals wish to defer.

Time-to-pay arrangements

HMRC has a well-established approach for concluding arrangements with taxpayers who are struggling to settle their tax liabilities as they fall due.

HMRC has established a dedicated coronavirus helpline to respond to time-to-pay arrangement (TTP) requests

(0800 024 1222). When agreeing a TTP, businesses should look to agree with HMRC a (realistic) instalment payment arrangement, suspension of debt collection proceedings, and cancellation of penalties and interest. If possible, businesses should contact HMRC before the due date for payment.

Again, advisers should note that TTPs are only a deferral and not a waiver of the tax due.

Other tax measures

Various other tax measures are worthy of attention as follows.

- There has been no automatic deferral of taxes for businesses (such as payroll or corporation taxes) other than the VAT payments or income tax payments on account mentioned above. Accordingly, those taxes will still fall due for payment as normal. If businesses are experiencing difficulties a TTP could assist.
- Duty deferment account holders and registered importers (who pay cash or an equivalent) who are experiencing financial difficulty as a result of Covid-19 can contact HMRC to extend the date for payment of import duties and, in the case of duty deferment account holders, without having their guarantee called upon or their deferment account suspended. Taxpayers will be asked to provide an explanation of how Covid-19 has affected their business finances and cashflow. HMRC will consider this request and decide whether to agree a payment extension on a case-by-case basis.
- If businesses are due tax refunds (for instance, VAT repayments), it is understood that HMRC is giving priority to making those payments.
- Some businesses will qualify for business rate relief and be entitled to business support grants. Eligible businesses will be contacted directly by the relevant local authority. However, if businesses feel they are eligible and are not contacted by the local authority they should instigate contact. Local authorities have discretion to reduce business rates for non-qualifying businesses if they can demonstrate financial difficulty and that giving relief is in the interests of local residents. Further, business rates are generally not applicable on empty properties for three months, after which time full business rates will apply subject to agreeing an extension with the local authority.

Debt management

Most companies will have some form of debt (be that trade debt or bank debt). Given the current operational disruption, companies will be looking at ways of managing their debt exposures with a view to managing ongoing liquidity. These can have tax implications and we will focus on the position for incorporated business debtors.

Debt renegotiation

Companies may look to amend the terms of existing debt to mitigate cash outflows – for instance by reducing the interest rate, extending the term, or deferring interest payments. If there is such an amendment, under accounting principles, this can sometimes give rise to an accounting profit for the debtor and, consequently, a taxable credit for UK tax purposes.

However, the debtor is not required to recognise a taxable credit under the loan relationship rules if it is reasonable to assume that, but for that amendment, there would be a material risk the debtor would be unable to pay its debts at some point in the following 12 months. Whether that test is satisfied will be a question of fact at the time of the amendment.

Further, companies may need to (re)assess the deductibility of interest payments on the amended debt (say under the transfer pricing rules if applicable or under the 'distribution' rules).

Debt refinancing

If renegotiation is not possible or not preferred, companies may refinance existing debts. As with any financing, the withholding tax position on interest payments (and the contractual allocation of risk) as well as the deductibility of interest payments will be important considerations.

As an alternative to cash interest-bearing debt, and to preserve cash, companies may consider refinancing their debt through funding bonds (payment-in-kind (PIK) notes) or issuing discounted debt. However the following points should be noted.

- Structuring debt as funding bonds does not eliminate any withholding exposure. Instead of paying a cash amount, the debtor would be required to withhold and account for the relevant amount of funding bonds to HMRC.
- In some cases, if discounted debt is issued the debtor will be unable to claim a deduction in respect of the discount until the debt is redeemed.

Debt releases

To mitigate cash outflows and strengthen balance sheets, sometimes, a third party creditor may be prepared to release all (or part) of a debt owed to it. In those circumstances, a taxable credit would generally arise to the debtor to the extent of the amount released in accordance with the accounting position. This treatment applies to any debt treated as a 'loan relationship' for UK tax purposes.

However, a debtor will not be required to recognise a taxable credit on a debt release if that debtor meets one of the prescribed insolvency-related conditions or if the 'corporate rescue' or 'debt-for-equity' exemptions are available.

In two circumstances, tax charges may also arise to a debtor if a debt is deemed to have been released under the UK tax code (even though the debt remains intact).

- The first is when a company acquires creditor rights under an impaired debt of a connected debtor company at an undervalue.
- The second is when an unconnected creditor and debtor are party to an impaired debt and then become connected.

In both cases, there is deemed release of any impaired portion of the debt resulting in a taxable credit for the debtor unless one of either (in both cases) the 'corporate rescue' or (in the first case only) 'equity-for-debt' exemptions apply. There is a broad targeted anti-avoidance rule which counters arrangements that seek to avoid a charge arising under the deemed release rules. These rules often fall to be considered when looking at 'debt buy-backs' (in other words, when a group company acquires creditor rights from a third party lender) or guarantee payments when a guarantor acquires creditor rights by way of subrogation.

Planning point

If the debt terms are amended, this may affect the deductibility of interest payments; for example, say under the transfer pricing or 'distribution' rules.

Debt-for-equity exchange

As opposed to a debt release, creditors may prefer to swap their debt for shares in the debtor company. Any taxable credit otherwise arising to a debtor on a debt release in those circumstances will be exempt from UK tax if the release is in consideration for the issue of shares forming part of the ordinary share capital of the debtor (or any entitlement to such shares).

If shares are issued to a creditor, and depending on the circumstances, this may have the effect of breaking tax groups or tax 'connections', which may trigger tax charges and/or the availability of tax reliefs.

> "To preserve cash, companies may consider refinancing their debt through funding bonds."

Trade debts

Companies may also be able to agree a release of trade debts. If the trade debt is a loan relationship for UK tax purposes, the rules outlined above apply. However, if the trade debt is not a loan relationship for UK tax purposes, the release of that debt will trigger a clawback of any deduction previously claimed in respect of that debt, unless the release is part of a statutory insolvency arrangement.

Final remarks

Of course, when it comes to liquidity and cash management, tax will rarely be the driving factor. However, the implementation of liquidity and cash management strategies can often be managed to mitigate tax leakage and, therefore, tax should not be overlooked when considering the options.

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