

HMRC Debt and Tax Arrears

Understanding VAT, PAYE, and Corporation Tax pressure and available options for directors.

HMRC is the most common creditor of companies entering insolvency proceedings in the UK. If your company owes money to HMRC for VAT, PAYE, National Insurance, or Corporation Tax, it is important to understand how HMRC operates as a creditor and what options are available to you.

How HMRC Debt Builds Up

Tax debts often accumulate gradually. A difficult quarter leads to a late VAT payment; cash flow problems mean PAYE is used to cover operational costs; Corporation Tax is deferred in the hope that the next quarter will be better. Directors frequently tell us that HMRC debt crept up on them while they were focused on keeping the business running day to day.

The problem is that HMRC debts carry automatic interest and penalties, so they grow quickly. VAT and PAYE are also treated differently from other debts because the money was collected on behalf of HMRC (from customers and employees respectively) and was never the company's to spend.

Common Types of HMRC Debt

VAT

VAT is collected from customers and held on trust for HMRC. Late or missing VAT returns attract default surcharges and penalties. HMRC views non-payment of VAT seriously because the company has already collected the money. Persistent VAT defaults are one of the most common triggers for a winding-up petition.

PAYE and National Insurance

PAYE and employee National Insurance contributions are deducted from employee wages and should be paid to HMRC each month. Like VAT, these are trust debts — the company holds them on behalf of employees and HMRC. Since December 2020, HMRC has held secondary preferential creditor status for these debts in an insolvency, meaning they are repaid ahead of unsecured creditors and floating charge holders.

Corporation Tax

Corporation Tax is payable on the company's profits. It typically falls due 9 months and 1 day after the end of the accounting period. While it does not carry the same "trust" character as VAT or PAYE, HMRC will pursue Corporation Tax debts with the same enforcement tools available for other tax debts.

How HMRC Enforces Tax Debts

HMRC has a range of enforcement powers that go beyond those available to ordinary creditors. These include issuing county court judgments, instructing enforcement agents (bailiffs) to seize company assets, applying for a winding-up petition to have the company compulsorily liquidated, and using direct recovery of debts from the company's bank accounts in certain circumstances.

Winding-up petitions: If HMRC presents a winding-up petition against your company, this is extremely urgent. The petition is advertised in the London Gazette, and once advertised, the company's bank will almost certainly freeze its account. This effectively prevents the company from trading and severely limits the options available. If you have received notice of a petition, seek advice immediately.

Time to Pay Arrangements

HMRC operates a Time to Pay (TTP) scheme that allows companies to spread overdue tax payments over an agreed period, typically up to 12 months. To be considered for a TTP arrangement, the company generally needs to be up to date with current filings, be able to demonstrate that it can afford the proposed repayment schedule alongside ongoing tax obligations, and show that the difficulties are temporary rather than structural.

TTP arrangements can provide valuable breathing space, but they are not always available. HMRC is less likely to agree where the company has previously defaulted on a TTP arrangement, the debts are very large, or the company appears fundamentally insolvent rather than temporarily cash-constrained.

HMRC's Secondary Preferential Status

Since December 2020, HMRC has been a secondary preferential creditor in respect of VAT, PAYE, employee National Insurance contributions, and certain other taxes collected by the company on behalf of others. This means that in a liquidation, these debts are paid after the expenses of the liquidation and preferential claims of employees, but ahead of floating charge holders and ordinary unsecured creditors.

This change has had a significant impact on recoveries for other creditors, including banks with floating charges, and has made HMRC's position in insolvency proceedings considerably stronger than it was previously.

Personal Liability for Directors

In most cases, directors are not personally liable for the company's tax debts. However, there are important exceptions. HMRC can issue personal liability notices to directors in certain circumstances relating to National Insurance contributions. Directors who have given personal guarantees to HMRC (which is rare but not unheard of) will be personally liable to the extent of the guarantee. Where a director has been involved in fraudulent conduct, HMRC may pursue personal recovery.

Important: Continuing to trade and incur further HMRC debts when the company is clearly insolvent can give rise to claims of wrongful trading against the directors. Taking early advice is the best way to manage this risk.

What Should You Do?

If your company has significant HMRC arrears and you are unsure whether the business can continue, the most important thing is to take advice promptly. The options available to you — whether that is a Time to Pay arrangement, a CVL, or another route — depend heavily on the specific circumstances, and the sooner you act, the more options you are likely to have.

Contact Insolvency Direct for a free, confidential discussion about your company's position. We deal with HMRC debt issues regularly and can give you practical, straightforward guidance on the best way forward.