



# TCSP Webinars

## **Session 2: Assessing Solvency in a COVID-19 climate**

2 July 2020

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# Introduction

**Format of the webinar**

**Asking questions**

**Further webinars and updates**

**Reference to materials / webinar playback**



# Webinar presenters



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## Solvency – definitions

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- Section 162(5) of the Companies Act 1931 states:

“A company may be wound up by the court if the company is **unable to pay its debts.**”

- Section 163(1)(3) of the Companies Act 1931 states:

“A company shall be deemed to be unable to pay its debts if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall **take into account the contingent and prospective liabilities of the company**”.

- Deemster Corlett in *Irvings v Carters* (2017 MLR N14 24 August 2017) at paragraph 249 referred to Lord Neuberger’s comments in an English case, in 2011:

“ In practical terms, it would be rather extraordinary if section 123(2) (of the English Insolvency Act 1986) was satisfied every time a company's liabilities exceeded the value of its assets. Many companies which are solvent and successful, and many companies early on in their lives, would be deemed unable to pay their debts if this was the meaning of section 123(2).”



# Cashflow example - SPV

Week	1	2	3	4	5	6
	22 June 2020	29 June 2020	06 July 2020	13 July 2020	20 July 2020	27 July 2020
Opening cash balance	6,000	6,000	750	450	200 -	50
Cash inflows						
Rental Income						
<b>Total cash inflows</b>	-	-	-	-	-	-
Cash outflows						
Corporate Services		5,000				
Property expenses		250	250	250	250	250
HMRC						3,000
Finance costs			50			
<b>Total cash outflows</b>	-	5,250	300	250	250	3,250
Net cash flow	- -	5,250 -	300 -	250 -	250 -	3,250
<b>Closing cash balance</b>	6,000	750	450	200 -	50 -	3,300



# Balance sheet solvency considerations example - SPV

	Book value At 22 June 2020	Estimated Realisable Value At 30 Sept 2020
	£'000	£'000
Property	250	175
Cash at bank	6	0
Debtor	4	0
Accrued service charges	-5	-8
Tax payable	-3	0
Loan	-200	-200
<b>Net assets/(liabilities)</b>	<u>52</u>	<u>-33</u>



# Contingent & prospective liabilities

## Examples

- Warranty claims
- Potential tax liabilities
- Possible damages arising from a breach of contract
- Potential claims arising as a result of historic events, but as yet have not been formally notified / crystalized to the company



# Summary assessing solvency



**Assets and valuation?**



**Total liabilities and how comprised?**



**Security**



**Directors**



# Approach to assessing solvency

- Cash book
- Simplification
- Risk approach
- Banking data



# Solvency issues

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The 3 main areas of law which arise in insolvency situations include:

## 1. Fraudulent preferences

- In a potential insolvency situation it is important to have regard to section 250 of the Companies Act 1931.
- Section 250 sub-section 1 states “Any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property which would, if made or done by or against an individual, be deemed in his bankruptcy a fraudulent preference, shall, if made or done by or against a company, be deemed, in the event of its being wound up a fraudulent preference of its creditors, and be invalid accordingly”.
- Under section 31 of the Bankruptcy Code 1892 the time period is within four months of the presentation of the bankruptcy petition, so in a corporate context within four months of the presentation of the winding up claim.

# Solvency issues

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## 2. Floating charges

- Section 251 of the Companies Act 1931 states “Where a company is being wound up, a floating charge on the undertaking or property of the company created within six months of the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount of the rate of 5 per cent. per annum”.

## 3. Fraudulent assignments

- Fraudulent Assignments Act 1736 states “all fraudulent Assignments or Transfers of the Debtor’s Goods or Effects shall be void and of no Effect against his just Creditors, any Custom or Practice to the contrary notwithstanding”.
- Deemster Cain in *Re Heginbotham* 1999-01 MLR 53 stated that “the expression “Fraudulent Assignment or Transfers” in the 1736 Act must impute *an intent* by the debtor to assign or transfer his goods or effects fraudulently, that is in the context of the relationship of debtors and creditors.”



# Secured creditors

- Fixed and floating
- Appointment of Receiver
- Complex structures



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# Late Returns – ATED Example

Tax charge: £25,200

## Late Payment penalties:

- 1 month @ 5%: £1,260
- 6 month @ 5%: £1,260
- 12 months @ 5%: £1,260

£3,780

## Late return penalties:

- Initial penalty: £100
- 3 Month @ £10/day: 900
- 6 month @ 5%: £1,260
- 12 month @ 35%: £8,820

£11,080

Total penalties **£14,860** (effective rate 59%)

## Solvency and foreign tax debts

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- No country directly or indirectly enforces the tax laws of another country
  - (*Government of India v Taylor* in 1955 [1955] AC 491; *Assessor of Income Tax v Holmcroft Properties Limited* 2016 MLR 404; *A* 2017 MLR 1).
- Under the Judgments (Reciprocal Enforcement) (Isle of Man) Act 1968 not able to register and enforce in the Isle of Man a foreign judgment on a foreign tax debt.
- The 1968 Act does not prevent reliance on an unregistered foreign judgment in the context of winding up proceedings
  - (*Obertor Limited v Gaetano Limited* 2010 MLR 150 Deemster Corlett (17 June 2010) and the subsequent appeal judgment SOGD 25 November 2010).

## Solvency and judicial discretion

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- Judicial discretion in winding up claims.
- Under section 165(1) of the Companies Act 1931 the court may dismiss a winding up claim, or adjourn the hearing conditionally or unconditionally, or make any interim order or any other order that it thinks fit
  - Deemster Doyle's judgement on 14 October 2017 in *Raymotors Limited* ;
  - *Shorts Gardens LLP v London Borough of Camden Council* [2020] EWHC 1001 (Ch);
  - *A Company (injunction to restrain presentation of petition)* [2020] EWHC 1406 (Ch).



# Practical tips



**Cashflow & financial position.**



**Review material contracts**



**Document decisions**



**External advice**



# Summary

- Judgement in assessing solvency
- GAAP accounting versus “reality”
- Importance, again, of good record-keeping
- No “magic solution” to fraudulent preference considerations
- Remember responsibilities to creditors

# TCSP Webinar series

**Join us for the final webinar in this series next Thursday at  
10:00am:**

- 9 July: Valuation of investments





# Thank you



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