



# Directors: Are you aware of your legal duties if your company is facing insolvency?

As the heat of summer continues to build, conversely we are witness to numerous chilling pressures being brought to bear on directors as they navigate through these challenging economic times.

Businesses across the board are experiencing increasing levels of bad debts, poor margins, over leveraged balance sheets and general financial insecurity.

When we factor in worryingly persistent inflation, a trend of rising interest rates, supply chain disruption, staffing issues, energy costs, an increasing tax burden, growing wage pressure and the continuing consequences of the war in Ukraine, the landscape looks decidedly bleak.

While the trading environment remains undoubtedly complex and challenging, all these uncertainties need careful planning in an effort to manage and mitigate the inherent risks. However when the business starts to run out of cash and the future looks worrying, it's time to reconsider your duties and responsibilities as a director. It may be time to take professional insolvency advice, and the Solicitor or Insolvency Practitioner will advise and guide you through the minefield of corporate and insolvency legislation, to avoid the pitfalls and potentially personal liability.

As a director, you are under a duty to act in the best interests of your company and its shareholders. However, the moment your company is deemed to be insolvent, you are under a legal duty to protect

the interests of your creditors. Going forward, the primary purpose of the company and its directors must be achieving the best return for creditors.

## General advice

- ✔ It is essential to maintain accurate and up to date books and records, including minutes of company meetings to document the decisions and views of the board and individual directors.
- ✔ You should properly establish the reasons for the financial difficulties of the business and consider your future business strategy for the company.
- ✔ Do not continue to trade / incur additional liabilities when the company is insolvent unless you can realistically and genuinely believe you can trade your way back to solvency, or secure additional funding. Document your decisions and where appropriate, take professional legal advice and consult an Insolvency Practitioner.
- ✔ Do not take deposits for orders which you know you are unable to fulfil.
- ✔ Do not pay one creditor to the detriment of the general body of creditors.
- ✔ Do not incur further credit or issue cheques when you know there is little or no prospect that you can honour those commitments.
- ✔ Ensure you receive the true market value for any assets sold by the company. Obtaining an Independent valuation is strongly advised prior to concluding a sale. Should you intend to sell any of the assets to an officer of the company, consult an Insolvency Practitioner prior to the transaction.

# What are my duties as a company director in liquidation and when do they cease?

Directors' duties cease at the date of liquidation, although the director's full ongoing co-operation and assistance is required by the Liquidator. The company's directors must:

- Give the Liquidator information about the company's affairs
- Provide details of its assets and liabilities
- Preserve and hand over the company's assets to the Liquidator; and
- Preserve and hand over the company's books, records, bank statements, insurance policies and other papers relating to its assets and liabilities.

# When can a director be held personally liable for the company's debts?

## Personal Guarantees

A limited company is a separate corporate entity and the main advantage for directors and shareholders is that they are not personally liable for the company's debts and liabilities. However, if you have signed a personal guarantee in favour of a creditor, you could be called upon to pay any shortfall, up to the limit of the guarantee plus interest. Engage with the creditor(s) early and regularly to open negotiations. Consideration should be given to maximising the sum obtained for secured assets prior to insolvency, although only after seeking advice from an Insolvency Practitioner.

## The Finance Act 2020

This provides for a person to be jointly and severally liable for amounts payable to HMRC by companies and LLPs in certain circumstances involving insolvency or potential insolvency. This includes directors and shadow directors, managers and shareholders. Since July 2020, HMRC can issue a joint liability notice to make an individual personally liable with the company for outstanding tax liabilities.

Such a notice can be issued in the following three scenarios:

- Tax avoidance and tax evasion cases
- Repeated insolvency and non-payment cases
- Cases involving penalty for facilitating avoidance or evasion

And where:

- The company is subject to an insolvency procedure, or there is a serious risk that it will be
- The person was responsible for the company's conduct, enabled or facilitated it, or benefited from it
- There is likely to be a tax liability arising from the avoidance or evasion
- There is a serious possibility some or all of that liability will not be paid

HMRC will decide whether all the specific conditions apply in each case, as set out in the legislation before issuing such a notice.

## Wrongful Trading

This occurs where the directors of a company (or shadow director – someone who is not a named director but who directs or controls the company) continue to trade when they knew or should have realised that there was no reasonable prospect of the company avoiding insolvent liquidation and the company then goes into liquidation. If a Liquidator suspects that this has occurred, he may apply to court for an order asking that the directors contribute to the company's assets. Unless you can prove that you took every step to minimise the potential loss to creditors, the Court may decide you have been wrongfully trading and it can order you personally to contribute to the company without financial limit.

## Fraudulent Trading

This is where you have carried on business with the intention to defraud creditors or for any other fraudulent purpose. Examples of which would include, taking deposits for orders that you know you can't fulfil, or entering into contracts where you don't have sufficient funds to complete the undertaking, giving wrong, inaccurate or false information with the general intention to deceive. If proved by the Court, then you can be personally liable to make a contribution to the company, without financial limit. You can also be imprisoned for up to 10 years, or fined, or both.

The distinction between wrongful and fraudulent trading can best explained with a couple of examples:

- Wrongful trading suggests mismanagement, rather than a deliberate attempt to defraud, and could include failing to pay company tax liabilities and file statutory returns.
- A case of fraudulent trading may be brought if a business has been allowed to continue trading, even though directors knew that suppliers or members of staff would not be paid.

### Misfeasance

This is where a breach of your legal fiduciary duties as a director has taken place. For example, money improperly withdrawn from a company or misappropriation of company funds for purposes not consistent with the business. On application by the Liquidator, the Court can compel the directors to repay, restore or account for the money or property, or contribute without financial limit such sums to the company's assets by way of compensation, if the Court so directs. On winding up, if the Liquidator identifies an illegal dividend paid to a director when there are insufficient distributable reserves to make that payment, then he/she will seek repayment from the Director personally.

### Unfair Preferences

You cannot make payments, or transfer assets to one creditor in preference to another. For example:

- Paying one or more creditors who are threatening legal action, including the Bank and HMRC
- Repaying family or friends
- Repaying your own director's loan account
- Actions to avoid liability under a personal guarantee

All creditors must be treated equally when the company is insolvent. The Court can set aside such transactions and order you or the benefactor to return the asset or repay the funds.

### Transactions at under value

Generally where ownership of an asset has been transferred for less than the market value. The Court can set aside the transaction if it decides that a transfer at under value has taken place. The new owners can be asked to restore the asset(s) in question to the company.

**In summary, if you are a Director, then as soon as you become aware that your company is in financial difficulty, you should seek appropriate independent professional advice and be guided by it. (May 2023: 01-220523)**

## About Opus

Opus Restructuring & Insolvency is part of Opus Business Advisory Group which includes an additional four distinct practices delivering the following services:

- Business Advisory
- Corporate Finance
- Forensic Accounting
- Equity

All our practices work together to help companies and individuals deal with the various financial and operational challenges as well as opportunities throughout all stages of the business life cycle. UK based with international expertise, the Group is focused on commercially driven results and takes a proactive approach towards tackling business challenges with an assurance of confidentiality.

## Contact Details

This briefing was written by:



### George Dale Partner - Restructuring & Insolvency

- ☎ 0131 322 8417
- 📠 07454 155 776
- ✉ [george.dale@opusllp.com](mailto:george.dale@opusllp.com)
- 🌐 [linkedin.com/in/georgedale](https://www.linkedin.com/in/georgedale)

### Disclaimer

*This article sets out some of the more common questions raised by Directors in such circumstances. It is not intended to be exhaustive or comprehensive guide to Director's duties and responsibilities under the Companies Acts, Insolvency legislation or the law relating to it. Directors are strongly advised to seek independent legal advice and speak to an Insolvency Practitioner.*