INSOLVENCY UPDATE

MESTON REID & Co
CHARTERED ACCOUNTANTS

Introduction

As we move towards the end of another tax year, the number of solvent liquidations tends to increase in order that shareholders can benefit from the current capital gains regime applicable to companies who have been actively trading in the last three years. An early capital distribution is always welcome and the risk of an adverse change to the rules by the Chancellor is at the back of many advisers' minds.

If you are considering a solvent liquidation process for a client, wish a capital distribution before 5 April 2018, and think that Meston Reid & Co can assist, please do not hesitate to contact us. Sooner rather than later please in order to make the necessary arrangements.

Consumer Credit : a constant challenge

Earlier this year the Bank of England published a Credit Report which showed that consumer credit continued to increase between 2016 and 2017. While many people can cope with existing repayments, challenging times may emerge for households already struggling with rising living costs if there is no wage growth and/or interest rates increase.

Lack of access to affordable credit means that many households on lower incomes tend to pay a higher price for credit and Step Change (a debt charity) published research recently estimating that over two million people are stuck in persistent overdraft debt. So much so that the Financial Conduct Authority have been called upon to eliminate unarranged overdraft charges in an attempt to allow those with low credit ratings to manage from one week to the next.

Steps have already been taken to try and contain interest charges on payday loans, although our TV screens are full of financial institutions offering quick loans at sky-high interest rates. Whilst any lender is required to factor into calculations the level of default that might arise in a total loan portfolio, interest rates in excess of 1,000% suggest an element of profiteering at the expense of those least able to access a high street Bank.

The money-lending industry is difficult to regulate, particularly informal cash arrangements. An adviser speaking to someone who feels pressed into borrowing money should always try to persuade the prospective borrower to shop around rather than feeling forced into a corner. Easier said that done!

Financial failure : end of the world or a lesson learned?

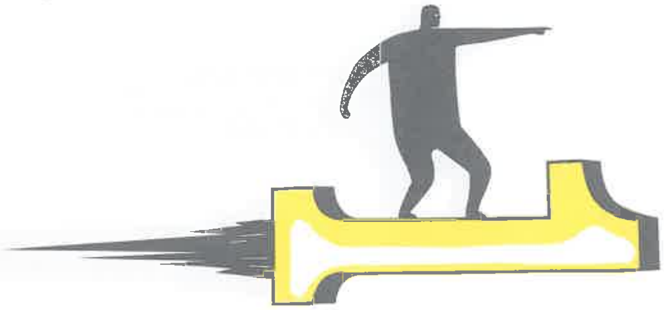
A report by the OECD a couple of months ago praised the UK economy in terms of its ability to absorb the failure of weak firms and emerge stronger as a result. Creative destruction e.g. allowing so called "zombie companies" to fail is fundamental to a well functioning economy because it helps to direct resources into the hands of more productive companies, according to the OECD report. The reasoning behind this is that companies can block the smooth operation of the financial system if they utilise capital that could otherwise be used by more innovative and creative companies with better prospects for economic growth.

UK insolvency regulations allow companies to close quickly, and means that capital can be directed towards those who can use it more effectively. In this way, innovation is encouraged by seeking to limit the cost of entrepreneurial failure i.e. get it over and done quickly, thus helping to avoid the stigma of financial failure : both corporate and personal. Creditors who lose a substantial amount when a business fails may not feel quite so supportive of the UK insolvency system but equally, one can accept the view that assets in non-productive hands are likely to yield less economic benefit than if used to better effect elsewhere.

Liquidation : no cash for me because the bank always takes it all

Following feedback from readers who did not see the following article in the Press & Journal Business Supplement when published, it is repeated below.

When a company is liquidated the general presumption is that, other than payments to former employees for unpaid salaries etc., the company's bank will receive all of the cash available from the sale of assets. This is not quite correct, but perhaps such view is taken because many people remain more familiar with what tended to happen before the enactment of the Enterprise Act 2002 which, amongst other provisions, introduced something called the "prescribed part".



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When a company borrows money, typically from a bank, a floating charge is granted. This is unlike a standard security because it does not relate to any specific asset but to all moveable assets (cars, book debts, equipment etc.) held by the company at any one time. It is only when there is an event which crystallises the floating charge e.g. the appointment of a liquidator, that the floating charge crystallises and seeks to preserve for the benefit of the holder of the floating charge whatever moveable assets the company has at such time (and not subject to any other specific security). In reality, anyone can hold a floating charge in respect of monies advanced to a company e.g. a parent advancing cash to a child's new company in order to help them start in business.

Until September 2003, the legislation tended to result in all liquidation cash being paid to the bank after certain preferred creditors had been paid : former employees and HMRC for VAT (last six months) and PAYE/NIC (last twelve months). Creditors knew this and tended to expect nothing when a company was liquidated

However, after September 2003 the floating charge position changed because the preference afforded to HMRC was removed completely. Rather than the bank receiving all of the cash, the introduction of the prescribed part meant that unsecured creditors such as trade suppliers and utility companies could share in asset realisations. Good news.

The prescribed part rules mean that the liquidator has to take 50% of the first £10,000 of asset realisations, plus 20% of anything thereafter subject to a cap of £600,000 (i.e. 20% of £3,000,000) and make such money available for a dividend to unsecured creditors.

It is not uncommon for directors to settle the floating charge debt when liquidation occurs if they have issued a personal guarantee to the bank. This helps to contain any ongoing interest that accrues until the floating charge debt has been paid, in whole or in part, from the liquidated estate. In such circumstances, directors are normally advised to seek an assignation of the floating charge such that, when the liquidator has concluded his asset realisation programme and is thinking about a dividend, the directors will rank above unsecured creditors for a return of most of their personal guarantee payment rather than share in the amount allocated to the prescribed part.

In summary, unsecured creditors should not simply assume that the bank will receive everything when liquidation occurs. Keep in touch with the liquidator and you never know : good news may emerge at some stage.

Who is handling my case?

The Meston Reid & Co insolvency team has experience of a wide number of cases, both formal and informal. So who is part of the team? This Update provides a brief interview with Michelle Byrne, department manager:

When did you join? March 1991

Most interesting case? An international investment company because it included a trip to Budapest and one of the challenges was trying to understand patents/approvals for US drug developments.

Do you come across many unsavoury characters? There have been a few, but most people have simply made a few bad choices or had some bad luck, and tend to appreciate help in a difficult situation.

Any heart-rending stories? Plenty.........but confidentiality means that I cannot provide details.

Best bit of business advice that you have received? Learn time and money management skills. Make lists! I love them! If you plan ahead effectively and budget your time and financial resources, you will reduce life's many stresses both at work and at home.

Best bit of business advice that you would give? Be prepared for success and if things are not going to plan, be prepared to ask for advice. Never be afraid to ask.

What would you do if you weren't at Meston Reid & Co? I'm too young to retire, so I would probably spend my time walking the dog, planning city breaks and maybe squeeze in the occasional lunch with friends.

What is your favourite film and why? Pretty Woman because it's ok to want the fairytale ending.

What is the charity closest to your heart? Aberdeen & District Cerebral Palsy Association. I am the chairman of this local charity which is run by a committee of volunteers. The committee fundraises to meet requests from individuals affected by cerebral palsy (adults and children) for equipment and services that are not provided by the NHS.

Conclusion

This Update is provided for general interest purposes and does not purport to offer definitive advice. Please contact either Michael J M Reid (reidm@mestonreid.com) or Michelle Byrne (byrnem@mestonreid.com) if you wish to discuss anything raised herein.

Thank you for taking the time to read this Update and feel free to pass it to anyone who you think might be interested in reading it

Meston Reid & Co