INSOLVENCY UPDATE

Is personal liability the way to tighten insolvency issues?

Recently-published UK government proposals to tighten up insolvency laws and address the business practice of 'phoenixing' have put a fresh spotlight on a notoriously tricky area of financial regulation.
Under the plans, company directors who dissolve their business to circumvent obligations such as staff payments and pension commitments could face substantial fines.

The legislative backdrop to this issue has repeatedly changed over the past 20 years as stakeholders ranging from HMRC and other government departments to private pension schemes have sought to protect their interests.

Amid these changes, the issues of what should be done to safeguard creditors and to deal with directors who act recklessly have been the focus of recurring debate.

Some promote the view that an insolvency in such circumstances should automatically mean a fixed-term directorial ban. But is that too draconian if, say, an individual director had no active role in the factors which caused the firm to go bust, or is a director of multiple other companies which are trading profitably and duly paying their taxes?

A recent HMRC consultation document rekindled the concept of company directors who have previously been involved in insolvencies lodging a security deposit, calculated on anticipated turnover, in an attempt to discourage bad insolvency practice. That in turn prompted the idea that perhaps every company should make a deposit – again based on turnover or profit – into a ring-fenced account.

HMRC's paper on 'phoenixing' – in which directors dissolve their business, buy the assets cheaply and start again under a new name, leaving creditors in their wake – has been assessed by bodies such as the Institute of Chartered Accountants of Scotland (ICAS). It suggested exploring the potential to transfer corporation tax liability from the old company to the new one, again as a disincentive.

In Norway, when a company goes bust, payroll deductions are a personal liability of the directors. It's not difficult to guess which bills take priority for payment at the end of each month or quarter.

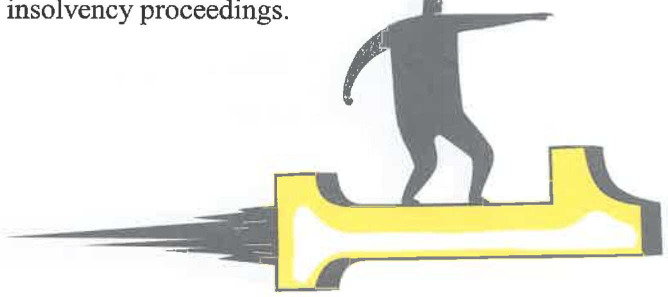
The principle of such accountability reflects other areas of modern-day corporate responsibility: personal liability. Until the issue becomes personal, to some extent, people will always be tempted to point to other sources of fault or seek a way to avoid paying their dues. Of course, as a principle, that may have its limits – a director of a large corporation owing £100million in taxes is not going to be liable for that sort of figure; it would have to be a solution of scale.

If this is to be the direction of legislative travel, the key rule for businesses is to address the risk of insolvency and the associated issues that contribute to it. Despite the daily pressures, smaller companies in particular should be highly vigilant about their cash flow and trading. It's not unusual for businesses to use money that will ultimately be used to settle their VAT bill as part of their everyday cash activities. That's all well and good, if there's a robust financial plan behind it. If you're in effect using other people's money, without a sustainable strategy in place, it can be very difficult to extricate yourself from problems when they materialise.

More broadly, perhaps it's time for the introduction of fit-and-proper or financial backing tests for prospective directors. At present, anyone can be a director; it's a simple form-filling exercise. If people were required to be members of a professional institution and to pursue development programmes, it would not only make them better directors – it would make clear the risks and responsibilities, as well as the rewards. It's important to encourage people into the world of business, but it's equally important to do so responsibly.

The Employment Rights (Increase of Limits) Order 2018

A number of people have asked Meston Reid & Co for clarification regarding how much is payable by way of unpaid salary, notice pay, redundancy and holiday pay when a business is subject to formal insolvency proceedings.



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With effect from 6 April 2018 the statutory limit of one week's pay increased from £489 to £508 i.e. this is the maximum that can be paid by the Redundancy Payments Office with any excess being paid from the insolvent estate should funds permit.

It is also instructive to note that the total amount that ranks preferentially for each employee i.e. paid in advance of the pot available to unsecured creditors, is £800. Thus, it is usual to see that the Redundancy Payments Office ranks as a preferential creditor for this sum because they have funded the payments to former employees and hence, assume their preferential entitlement.

The State is due more than credit card companies!

A recent study by the National Audit Office "NAO" has shown that consumer debt has declined from 52% of all problem debts reported to Citizens' Advice Bureau in 2011/12 to 33% in 2017/18. This may be because of tighter rules on private borrowing, making it easier to take credit from the Government, because the NAO report advises that monies due to the State represent about 40% of all problem debts. Indeed, the report estimates that all debts and arrears owed to the State as well as utility providers are more than £18 billion, which includes money due by way of council tax arrears, benefit overpayments and income tax.

The same report suggests that £15 billion is due by way of mortgage arrears and offers the recommendation that "Government needs to understand the scale and nature of problem debt in order to determine a sufficient and targeted response".

Personal insolvency legislation changes

Two pieces of legislation come into force on 29 October 2018. They are the Common Financial Tool (Scotland) Regulations 2018 which help to standardise the method of scheduling a person's assets and liabilities whilst helping to calculate a contribution from earnings depending on the level of regular outgoings, and the Debt Arrangement Scheme (Scotland) Amendment Regulations 2018 which provided clarity on a number of operational issues e.g. the DAS register does not need to provide full access information to an individual where the DAS administrator is of the opinion that such information could put a person at risk of violence or otherwise jeopardise their safety : bringing this aspect into line with existing sequestration and trust deed proceedings. The Regulations also clarify the requirement for a continuing money advisor's fee to be disclosed.

The legislation provides various schedules for completion in terms of disclosing all types of income, including that of a debtor's partner, together with expenditure summarised in categories such as transport, travel, utilities, home support costs etc. The regulations also provide helpful guidance regarding a business DAS, perhaps in the hope that this type of insolvency process will be used more often, and notes that a joint DAS does not have to be between a husband and wife but can be either civil partners or a couple living together as if married.

Husband and wife banned as directors

Mr & Mrs Miah, directors of Murrayfield Developments Limited, operated a company known as The Original Raj Hotel in Edinburgh. The Insolvency Service investigated their conduct after the company was liquidated in December 2015 owing creditors over £260,000. The investigation found that Mr & Mrs Miah had failed to either preserve or deliver the accounting records to the liquidator which made it impossible to account for over £1 million withdrawn from the company's bank account, including cheques written to "cash" after the commencement of liquidation.

Neither Mr nor Mrs Miah attended court and after hearing the evidence presented, the sheriff disqualified husband and wife from being a company director for a period of seven years.

GDPR

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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