



DIRECTORS PERSONAL LIABILITIES FOR LIMITED COMPANY DEBTS

The issue of personal liability generally arises up for directors at the point of insolvency. As the company enters liquidation or another insolvency procedure, directors wonder if they will be held accountable for any of the losses (Australian Securities and Investments Commission, 2019).

The key piece of legislation outlining liability is the Insolvency Act 1986. Here are the key sections within that:

WRONGFUL TRADING

Section 214 of the Insolvency Act refers to 'Wrongful Trading' which is the term used to describe the actions of a director who, knowing the company was insolvent, failed to put the interests of creditors first (Australian Government, 2016).

Wrongful trading is not something conducted out of connivance or willful desire to defraud. Rather it is about ignorance of due procedure, and a failure to understand the rules.

For example:

A director who understands that the company is insolvent might pay himself out of the last money in the account simply because he needs to pay his mortgage on time. That action qualifies as wrongful trading because it's putting his own interests before those of company creditors (Australian Securities and Investments Commission, 2019).

FRAUDULENT TRADING

Section 213 of the Insolvency Act refers to the more serious charge of 'Fraudulent Trading', which means that any actions taken by the director were done 'knowingly.'

Defrauding creditors or any other member of the business may be held personally liable to contribute to the assets of the business (Australian Government, 2016).

MISFEASANCE

Section 212 of the Insolvency Act covers 'misfeasance' which is the term used to describe 'misfeasance' (improper activity) or a breach of fiduciary duty. Essentially this covers activities surrounding use of money such as when dividends are issued inappropriately, or unauthorised remuneration to directors (Australian Government, 2016).

Transactions at an undervalue

Section 238 of the Insolvency Act covers the situation where an officer of the company sells an asset at less than market value in a way that results in less return for creditors.

For example, if a company is insolvent and a director sells a company property to a family member for a less-than-market rate, it could result in personal liability for the amount missing (Australian Securities and Investments Commission, 2019).

PREFERENCES

Section 239 of the Insolvency Act refers to the situation of one creditor receiving preference over another.

For example, should the director pay one supplier – on the basis of long and trusted relationship – post become aware of the company's insolvency, he/she could find themselves personally liable as, overall, the creditors find themselves worse off.

CAN SOLE TRADERS AND PARTNERSHIPS BE HELD PERSONALLY LIABLE FOR BUSINESS DEBTS?

If you run your business as a sole proprietorship, you and your business are legally treated as the same entity, which means you'll be personally responsible for repaying every penny the business can't pay. In this case, if your business does not have the money or assets to repay its debts, creditors can, and sometimes will take personal assets to reclaim the money that is owed.

Partnerships in the UK can be run as limited partnerships or limited liability partnerships. In a limited partnership, 'general' partners can be personally liable for all the partnership's debts, while 'limited' partners are only personally liable for the amount they invest in the business.

In a limited liability partnership, the partners are not personally liable for debts the business cannot pay, so their liability is limited to the amount of money they invest in the business (Australian Government, 2016).

Debts from Private Limited Companies

Private limited companies are a separate legal entity to their shareholders and directors, and as such, they have no personal liability for the debts of the company. The shares in a private limited company are not available to the members of the public, so the shareholders and directors of the company will often be the same.

Despite the protection offered by limited liability partnerships and private limited companies, there are still some common ways the owners and directors of companies structured in this way can be made personally liable for company debts (Australian Securities and Investments Commission, 2019).

SIGNING A DIRECTOR'S PERSONAL GUARANTEE

Banks, suppliers and landlords understand that the directors or private limited companies and limited liability partnerships do not have personal liability for the company's debts, many will refuse to extend credit or loan money to small businesses without the owner's personal guarantee.

If you have signed a director's personal guarantee on any loan, lease or contract, you will be made personally liable for the debt if the company is unable to pay. Typically, personal guarantees are required on loans for business vehicles or equipment, a credit line from a bank, or a commercial lease.

Circumstances alter slightly for a personal guarantee in liquidation. But the debt remains unsecured unless you have specifically offered assets as security.

USING YOUR PROPERTY AS LOAN SECURITY

In some circumstances, banks and building societies will require the owners of private limited companies and limited liability partnerships to use their home or other personally held assets as security on loan. If your business defaults on loan, the lender can repossess the asset and use the proceeds from its sale to repay the company's debt.

Funding the business with credit cards or personal loans

If you use personal credit cards or home equity loans to increase the capital in your business, you will always be personally liable for those debts. In fact, you will almost always be personally liable for making payments on a business credit card under the terms of the credit card application you signed (Australian Government, 2016).

FRAUD, MISREPRESENTATIONS AND INSUFFICIENT RECORD KEEPING

If you lied or misrepresented any of the facts while applying for a credit or loan agreement on behalf of your business, you could be held personally liable for the debt.

Similarly, if you failed to maintain a formal separation between your personal and business finances, creditors could also pursue you personally for business debts. You are also obliged to preserve and maintain accurate company accounts. If you fail to do so, you could be made personally liable for some of the company's debts.

If your company is experiencing financial difficulties, the moment the company becomes insolvent, i.e. it can no longer pay its debts when they become due, you are legally obliged to act in the best interests of your creditors. If your company becomes insolvent and you are engaged in any of the following practices, you may be held personally liable for the debts of the company:

- Continue to trade with no intent to repay your debts
- Repay debts through fraudulent means
- Sell assets for less than they're worth
- Favour some creditors over others
- Pay yourself and not your staff or creditors



DIRECTORS PERSONAL LIABILITY FOR DEBT DURING INSOLVENCY

When a company becomes officially insolvent, any insolvency practitioner will be on the look out for 'wrongful trading' which is an indication that the director did not behave in a way that was intended to maximise the return for company creditors (Australian Securities and Investments Commission, 2019).

If you suspect your company is insolvent, or close to it, our suggestion is that you behave with the utmost diligence, and make contact with us as soon as possible for advice. It's also worth checking to see whether there is an overdrawn directors' loan account within the company as this can be quite serious as the business becomes insolvent.

HMRC will want to see evidence that you:

- Always placed creditors interests first once you understood the company's financial position
- Kept clear lines of communication with both creditors and shareholders
- Did everything you could to find new business and manage your debts responsibly
- Took Professional Advice

You can read a full article here on Wrongful Trading.

CAN SHAREHOLDERS BE MADE LIABLE FOR COMPANY DEBTS?

Related to the subject of directorial liability is the question of whether company shareholders can be made liable for corporate debts. As with directors, shareholders enjoy the limited liability status which mean they are largely protected for incurring responsibility for debts. There are exceptions to this which include:

- Where a shareholder or group of shareholders have personally guaranteed a debt
- Where shareholders have acted improperly or fraudulently, (this holds for any individual, not just shareholders), for example using company money for personal use (Australian Securities and Investments Commission, 2019).

The above information as been taken from the Australian Security and Investment Commissions website (ASIC) For more information please visit ASIC: <https://asic.gov.au>.

References:

Australian Government. (2016, February 29). Insolvency Law Reform Act 2016. Retrieved October 2020, from Federal Register of Legislation: <https://www.legislation.gov.au/Details/C2016A00011>

Australian Government. (2020, June 24). Business structures. Retrieved October 2020, from Business <https://www.business.gov.au/planning/business-structures-and-types/business-structures/>

Australian Securities and Investments Commissions. (2020, September 07). Insolvency. Retrieved 2020 October , from Australian Securities and Investments Commission (ASIC): <https://asic.gov.au/regulatory-resources/insolvency/>

Australian Securities and Investments Commission. (2019, May 01). Company director liabilities when things go wrong. Retrieved October 2020, from Australian Securities and Investments Commission (ASIC): <https://asic.gov.au/for-business/small-business/starting-a-company/small-business-company-directors/company-director-liabilities-when-things-go-wrong/>

Queensland Government. (2017, July 18). Company Business Structure. Retrieved October 2020, from Business Queensland: <https://www.business.qld.gov.au/starting-business/types-legal-structures/business-structures/company#:~:text=By%20law%2C%20a%20company%20is,general%20public%20through%20share%20issues>