Options in insolvency

Companies provide limited liability for their shareholders, but *Richard Simms* warns that personal guarantees are becoming more common.

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FURTHER INFORMATION

FA Simms & Partners has been involved with the IFA for many years and is the Institute's chosen partner to support members with client insolvency and cash flow matters.
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TEN SECOND SUMMARY

1. **Despite the protection of limited liability, many companies will involve a director providing a personal guarantee for company borrowings.**
2. **Increasingly, the corporate non-payment of taxes through insolvency will come under government scrutiny.**
3. **The fact that a company with outstanding debts has been struck off from the Companies House register, will not prevent it being reinstated by HMRC.**

Having trained as a chartered accountant and licensed insolvency practitioner, in 1999 ***Richard Simms*** took over the role of managing director at FA Simms & Partners, a long-established insolvency and rescue practice. Richard is also a director of the Anti-Money Laundering Compliance Company Ltd (AMLCC).
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Companies House registered its first company in 1844 and it's fair to say that limited liability remains a key attraction to using a limited company. Perversely, it's rare that we see a company director in a company insolvency that has not given at least one personal guarantee for company borrowing.

Such personal liability is often extended with personal lending to the company and borrowing from family and friends. It is now common to see such guarantees written in to supplier account agreements. These are often a surprise and are increasingly prevalent in the construction sector.

Many personal guarantees and borrowing from connected parties are taken out within 12 months of a company facing potentially terminal insolvency threats. The apparent ease that personally guaranteed borrowing can be obtained when a company is facing significant financial pressures is a worry. However, the mindset of a company director who is desperate to see their company recover back to its previous performance or to lift off in the first place is clear to see.

Often, it is only the action of a third party either withholding further credit or taking legal action to push a company to formal insolvency that leads to the final decision by a company director to take advice on what the next steps could be.

Would a client come to you for advice before taking out a chunk of company borrowing?

Taking advice

Where to turn for help is a key decision. Advice from a friend or family member seems to be the first port of call for many. A friend who is a professional brings an extra option for some, whereas advice from an expert down the pub can be alarming but is often sought.

I spoke to a client recently who had been told explicitly that repayment of funds introduced by a company director (without security) was a legal right and would not be challenged. The truth is somewhat different.

Some may contact their accountant for help. However, if asked, I wonder how many could name those clients who are likely to ask for help and those who are not?

The online world provides another source of information and guidance. But who does anyone trust? Just because someone's business is facing financial difficulties doesn't make them a fool. However, if someone is gullible or naive in business, facing difficulties will not make them less so. This is where a director could be open to the hard sell by experienced sales agents pushing their firm's services.

If someone is susceptible to a good sales person and is too inexperienced to ask key questions, there is a strong chance that the individual will be drawn in and sign up without, perhaps, having the full picture in front of them.

Company insolvencies

When considering where they stand on company insolvency, advisers need to ask themselves the following questions.

- If there is limited liability, must there be a formal insolvency option?
- What is correct level of personal risk associated with a limited company?
- What skills, knowledge and experience should be required to be a director of a limited company?

Why are these questions any more relevant today than in the past? First, transparency and availability of information. The increasing ease with which historic transactions can be recreated and analysed make it more difficult for someone to cover their tracks. It is also difficult not to see the progressive shift of HMRC's view of tax avoidance and the negative view taken by the general public and media of those who are discovered to be using tax avoidance schemes.

Place these two factors together and it's not a huge jump to see that non-payment of taxes through insolvency will be something that increasingly will come under government scrutiny.

We dealt with a case earlier this year – a food take-away outlet. The company that ran the outlet had been under investigation by HMRC. The accountants had put the client in touch with a tax adviser who had been liaising with HMRC and had made a without prejudice offer to the department to agree a liability on about £250,000 of undeclared cash takings.

From our perspective, we are responsible for determining the correct liability and, more importantly, the director's personal liability. The case is ongoing, but my expectation is that if we are not successful in establishing personal liability of the director, HMRC will pursue under tax laws.

This brings to mind another case in which the Revenue is pursuing a personal penalty against a director for non-payment and disclosure of a VAT debt. The director is keen to make amends and is seeking to repay HMRC in full. What if the director does receive a personal penalty, what would have happened had the company simply been liquidated and not declared its position to HMRC by way of a disclosure?

We would, I hope, have found the error in the accounts and then had to consider where the funds that should have paid HMRC had gone to and the appropriate breaches of law under which a recovery might be pursued.

I wonder where tax laws and insolvency will meet in the end.

Striking off

Is striking-off an insolvent company still an option? For some years there has been a trend of inflating the cost of company strike-offs to make easy money from company directors who knew no better or were keen to avoid the investigation associated with a formal insolvency process.

We have seen quotes of thousands of pounds to undertake a strike-off process. From what we could ascertain, the cost quoted was usually exactly the same as the amount of funds remaining within the company.

It is worth being aware that we have been told about several incidences of companies that have been struck off from Companies House with debts outstanding to HMRC, but being put back on the register by the department. At the same time as being put back on the register the company is placed into compulsory liquidation.

There is also a consultation on powers of investigation and prosecution of directors of companies that were struck off without passing through any form of formal insolvency process.

The best options

What are the best options for the directors of an insolvent company? In the context of what has been discussed so far, the first option to be considered is whether there is any basis of repayment of creditors without recourse to a formal insolvency process.

HMRC is often the only or main creditor, so the first test that must be met to avoid formal insolvency is whether the department can be paid back in full in a reasonable (acceptable) timeframe. It feels that such a repayment structure may receive a slightly fairer hearing than that received when a formal company voluntary arrangement (CVA) is made.

As I think about this, that makes sense. I struggle sometimes when an offer to repay creditors in full under a CVA is rejected out of hand without what feels like full consideration. If no such informal option exists, recourse to options under the insolvency act will need to be considered.

Who is responsible for company insolvency?

The point of view from which a person looks at a case of insolvency will be a key influence on their view of who is responsible. Obvious yes, but how wide is culpability for insolvency? Is it the lender that wouldn't advance more funding or the lender that did advance, but only with a personal guarantee? Is it the supplier that wouldn't supply any more or the one that did advance beyond the credit limit?

In reality, experience tells me that many companies that face insolvency simply did not see it coming and, despite their best efforts, could do nothing to prevent it. I remember having to deal with the closure of one of the last vinyl record shops; how could it have survived the previous 15 years and continued to do so until vinyl was back in fashion?

How advisers position themselves with their clients will determine the breadth and effectiveness of their role with any client-facing financial difficulties.