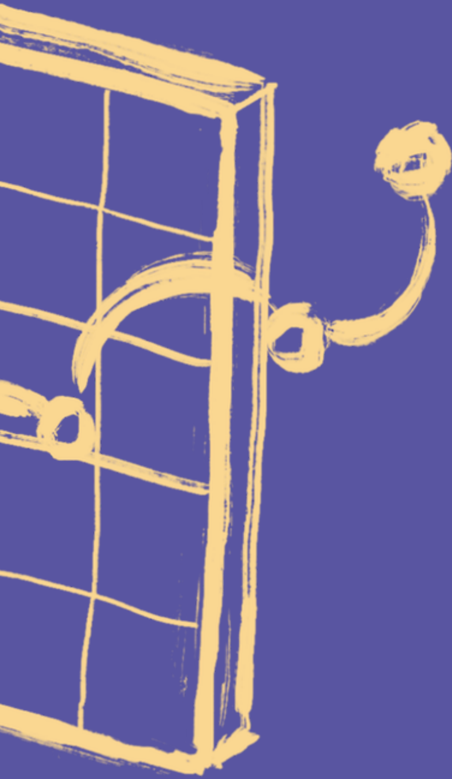
Henderson Loggie

A Director's Guide to Insolvent Liquidation

All you need to know

Contents



Welcome	3
Why see an Insolvency Practitioner?	4
What happens if the company is insolvent?	5
FAQs from Directors	6
Limited Liability	7
What are my employees entitled to if my business enters insolvency?	8
What is a protective award?	9
Director's Loan	10
How DLA transactions are treated in insolvency	11
Phoenix Companies: re-use of Company names	12
How can we help?	13
Get in touch	13

Henderson Loggie

Welcome

At Henderson Loggie, our Business Recovery & Insolvency team is dedicated to offering clear, practical, and professional guidance to help you navigate the complexities of insolvent liquidation.

Whether you are facing financial difficulties, considering restructuring options, or seeking to manage the liquidation of a distressed company, this guide is designed to provide a thorough understanding of the insolvent liquidation process and how it can help you achieve the best possible outcome for your business.

With our deep expertise and client-focused approach, we strive to make the liquidation process as smooth and efficient as possible, ensuring you are supported throughout and that the best interests of all parties are considered.

Henderson Loggie

Why see an Insolvency Practitioner?

We know that clients in financial distress may resist recommendations from their trusted advisors that they should speak with an Insolvency Practitioner (IP). There are a few reasons for this including the misconception that Insolvency Practitioners (IPs) should only be consulted when a company is ready to enter insolvency and a belief that consulting an insolvency practitioner will only have one outcome – an insolvency. Thereis also often a reluctance to face up to the reality of the situation.

1. To understand all the options

IPs are licensed and regulated experts in dealing with financially distressed companies and individuals. At a time when those in the middle of a financial crisis are often too entrenched in the day-to-day stressful process of trying to keep things afloat, an IP can do an independent review of the situation then give clear, impartial guidance as to the true financial position and available options.

Apart from insolvency, these options might include negotiating reduced settlements or time to pay agreements with creditors.

Negotiating new or restructuring existing financing may be the answer.

Each or a combination of all can be done informally or as a formal Creditors Voluntary Arrangement, ultimately rescuing the business and saving jobs, avoiding formal insolvency.

2. To know what the worst-case scenario looks like

Whilst it is always good to hope for the best, it is also wise to prepare for the worst.

IPs understand how much directors invest, emotionally and financially, in their business, and how difficult that makes facing potential closure. Whilst they see the signs of distress like cash flow problems; increased debt, typically with HMRC; falling profits, often due to price cuts to win business in the misguided hope that a busy business is a profitable one, it is difficult to face the true position. The IP can make an independent assessment and place the basic facts before directors to facilitate a frank and honest discussion about the state of the business together with the options and practicalities of winding up the business to maximise return and minimise stress.

IPs can advise directors if they are at risk of accusations of misfeasance by, for example, paying a preferred creditor or selling assets at undervalue, or of wrongful trading if, knowing the business is insolvent they carry on trading and the company position worsens, in addition to potential issues of personal liability for company debt.

3. To take back control of the situation

In addition to the worry of paying wages, paying creditors, and winning new work, the additional stress of creditors' potentially forcing the company into liquidation often leaves directors feeling powerless to deal with the fate of their businesses.

A conversation with an insolvency practitioner will clarify the practical steps that can be taken by a director and the consequences of any actions taken.

What happens if the company is insolvent?

There are two main ways to close a company and bring its affairs to an end.

Firstly, there is a formal insolvency process, such as a liquidation, where an insolvency practitioner is appointed to wind up the affairs of the company.

Secondly, the company itself can be "struck off" from Companies House, which is the register for all companies, and then dissolved.

In all formal insolvencies, the appointed insolvency practitioner is required to submit a report on the conduct of the directors to the Insolvency Service. The Insolvency Service is a government department that reviews all these reports and may take action to disqualify a director who has acted in such a way that was unfit. Directors can be disqualified from acting as a director for up to 15 years.

FAQs from Directors

Henderson Loggie

1 Can I still be a company director?

A director of a company that is in liquidation, can still be a director of other companies at the same time/ can take on new directorships/set up new companies. The exception are where they have been disqualified by Insolvency Services, to act as a director; they are an undischarged bankrupt or have been convicted of certain types of offences.

2 Will the liquidation be made public?

Apart from adverts placed in publications to ensure the company and creditors are aware of the winding up process, the information will also publicly available on Companies House until such time as the company is removed from the register, usually three months after the end of the liquidation, This should have no effect on a director's personal credit rating and they can still hold positions in public office.

3 Can I start a new business?

In most circumstances, a new company can carry out a similar business as the insolvent one, but the director needs to ensure that they have addressed whatever caused the liquidation. A new company cannot trade using the same or similar name unless specific requirements are met.

4 Will I be held personally liable for company debts?

A director will normally not be personally liable for any of the company debt unless they have provided personal guarantees. If they have personally guaranteed company debt, those creditors will look to them personally for repayment.

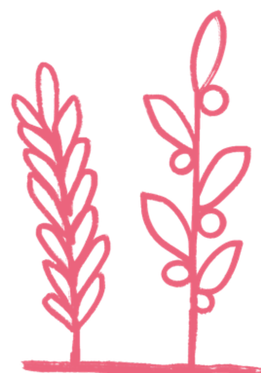
They may be personally liable for debts incurred by wrongful trading. This is where company debts have increased in a period when the director ought to have known that there was no reasonable prospect that the company would avoid insolvency. Wrongful trading was temporarily suspended until 30 September 2020 but is now back in force.

6 Will there be any action to have me struck off as a director?

In any insolvency procedure, the insolvency practitioner must investigate the conduct of the directors and submit a report to the government on adverse conduct. If there is adverse conduct this may lead to directors being unable to act as directors for a set number of years. Some of the areas that must be reported on are:

- Keeping adequate books and records
- Keeping tax returns and payments up to date
- Preferring certain creditors over others
- Has the director benefited excessively?
- Giving away company assets for less than they are worth
- Taking customer deposits when it is known that the goods or service will not be provided
- Trading whilst insolvent
- Not co-operating with the liquidator

Certain specific circumstances may have an impact on the position above. Any individual facing individual or corporate insolvency should speak to an insolvency practitioner.



The protection given by limited liability is a privilege, not a right.

What is limited liability?

Limited liability means that when a business fails the personal belongings of its owners are protected. It encourages entrepreneurship which is a good thing for the economy.

To benefit from this protection, company directors have legal responsibilities including keeping proper accounting records and filing accounts and confirmation statements at Companies House.

Company directors must also exercise reasonable care, skill and diligence and avoid conflicts of interest. The obligations apply to those who act as if they are a director and not just those who have been legally appointed.

When a company becomes insolvent certain conduct by a director may mean that the privilege of limited liability is lost. In these circumstances, the personal belongings of directors (and those acting as directors) may be at risk.

How can you tell if a company is insolvent?

It can sometimes be difficult to tell whether a company is insolvent. Some signs of:

- having creditors issuing reminder letters and starting legal action
- accounts being placed on stop or pro forma
- liabilities being greater than assets
- HMRC arrears

What is wrongful trading?

When a company is insolvent the director must put the interests of the creditors ahead of their own.

A director may claim that they did not know that their company was insolvent, but they will lose the limited liability if they ought to have known. If a director continues to trade whilst insolvent it can mean that they are personally liable for the debts of the company. This is called wrongful trading.

What are my employees entitled to if my business enters insolvency?

Henderson Loggie

In a formal insolvency when there is no money to make payment of the employees' statutory entitlements, the Government will step in and make these payments. A formal insolvency means that there must be a liquidator, administrator or receiver appointed to a company or LLP and a trustee in bankruptcy in the case of sole traders and individuals. The Government will not pay out if one of these is not in office. There must be a formal insolvency practitioner in office.

What is an employee entitled to receive?

Employees are entitled to receive unpaid wages, holiday pay, statutory notice pay and statutory redundancy pay.

Unpaid wages – this is money that should have been paid for work that has been done. It includes overtime, bonuses and commission.

Holiday pay – this is for holidays that had been accrued but had not taken. It is capped at 28 days entitlement.

Notice pay – An employee is entitled to receive notice before being made redundant. Only statutory notice from the government will be paid even if a contract has different notice provisions. The statutory redundancy notice periods are:

- one week's notice if employed between one month and 2 years
- one week's notice for each year if employed between 2 and 12 years
- 12 weeks' notice if employed for 12 years or more
- Statutory notice is capped at 12 years. This means that it is likely that different employees with the same job and rates of pay will be entitled to different notice periods.

Redundancy pay – This is due to any employee who has worked for the employer for at least 2 years and the entitlement is:

- half a week's pay for each full year the employee was under 22
- one week's pay for each full year the employee was 22 or older, but under 41
- one and half week's pay for each full year the employee was 41 or older
- Length of service is capped at 20 years.

Cap on payments

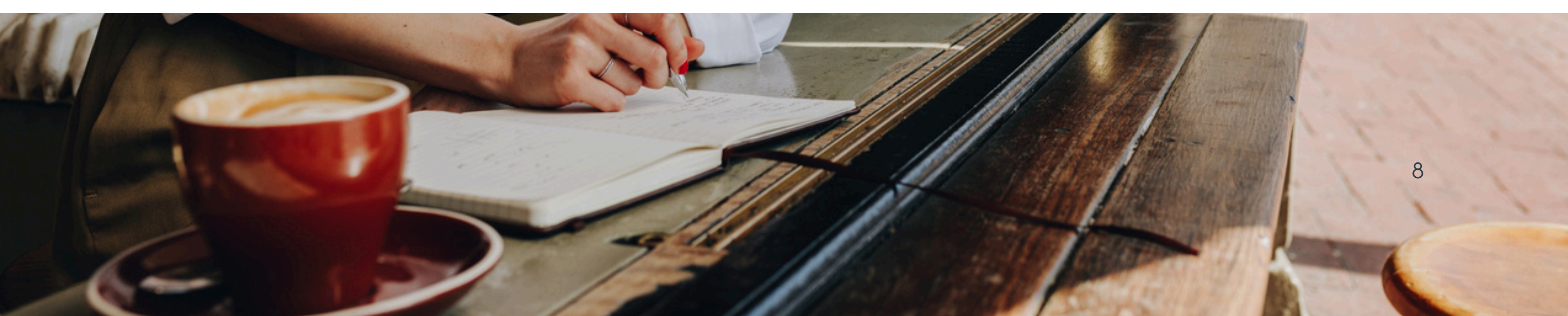
Payments made by the Government are subject to a weekly limit, which may increase every April. The current rates can be found at https://www.gov.uk/redundancy-your-rights/redundancy-pay.

This means that if an employee earns less than the statutory limit they will be entitled to the full amount, however, if an employee earned over the limit the weekly payment will be capped at that limit and any balance of sums due to an employee over and above this would be a claim in the insolvency. It should be submitted by the employee to the liquidator, administrator or trustee and will sit to be ranked for a dividend with all other creditors.

An employee can claim for unpaid expenses. For example, travel expenses which were incurred personally in carrying out their job which would normally be paid on submission of an expense claim.

Subcontractors do not qualify as employees and will not be entitled to any payment for unpaid services from the government. Subcontractors will have to make a claim in the liquidation.

However, if a subcontractor believes their relationship with the company could be classified as an employment relationship, e.g. they worked exclusively for the company under terms resembling employment, they should seek legal advice on their position



What is a protective award?

Henderson Loggie

A Protective Award may be made where the employer has failed to adhere to the redundancy consultation process.

If an employer is making 20 or more employees redundant, they must adhere to legal requirements including entering into a consultation process. There is no time limit for the length of the consultation process but there are minimum time limits of at least 30 days before dismissal for between 20 to 99 employees and at least 45 days if there are 100 redundancies or more.

To get an Award there is a requirement for the employee to have an employment tribunal judgement in their favour. If the employer is solvent, then the employer must pay this. If it is insolvent the award will be paid by the Government, capped at 8 weeks wages at the statutory limit.

Full details of Protective Awards can be found on the Insolvency Services website here.

Are company directors entitled to redundancy payments in an insolvency?

If the director is an employee, then they will be entitled to the same payments as other employees. However, the director needs to be able to prove their status as an employee. Typically, this would be evidence of a formal employment contract or payment of PAYE and NIC on payment made to the directors. The director must complete a form to provide details of what their relationship with the company was. This covers contracts and PAYE but also looks at how many hours they worked and what they did. The Insolvency Service will review this to assess whether the director was an employee. If a director can provide satisfactory evidence of their employment, then a claim for redundancy pay and any other sums owed to them in respect of holiday pay, arrears of wages etc can then be submitted online through the Insolvency Services the same as any other employee. Each case will be determined on its own specific circumstances.

Before paying anything out to a director, the Insolvency Service will confirm whether there was an overdrawn director's loan balance at the date of the appointment. An overdrawn director's loan balance is where the director is due to pay money back to the company. If this is the case, then the Insolvency Service will deduct the amount outstanding from any payment they make to the director in respect of his employee entitlements. This has only been the case since 2016 when the Insolvency (England and Wales) Rules 2016 introduced the right of set-off in relation to mutual dealings and these are Rule 14.24 in respect of Administrations and Rule 14.25 in respect of Liquidations, and the Insolvency Service have advised that the Rules also apply in Scotland.

So, is a director entitled to employee payments from The Insolvency Service when their company enters insolvency? Well, the answer is maybe.

Director's Loan

A company must keep a record of a director's loan account. This will show cash withdrawals paid directly to a director and any personal expenses of the director paid for by the company. Personal expenses are anything that was not incurred for the purpose of the business and must be paid back.

At the end of a period, the director will either owe money to the company or the company will owe money to the director. Interest should be charged on the loan.

A director's loan can be offset by the payment of a dividend if there are sufficient funds available. If not, there will be an overdrawn director's loan account. If the business continues to trade then the loan can remain outstanding until it is either repaid by the director, or there are future profits to allow offset by dividend. If it remains outstanding more than 9 months after the end of the accounting period, there will be corporation tax to be paid on it (known as s455 tax).

What happens when a company with an overdrawn director's loan account enters insolvency?

When a company enters insolvency and there is an outstanding director's loan, it will need to be paid to the liquidator. Most liquidators will agree a repayment plan where this can be paid by instalments over a period of time.

If the accounting records are not up to date, a liquidator will look at the transactions the company has undertaken to establish whether there is a director's loan outstanding or additional sums to be added, or deducted from the last loan recorded.

Where, for whatever reason, for example personal insolvency, a director does not repay a loan in a liquidation, the loan may be converted to income and HMRC will look to recover income tax on same from the director.

Can a company with an overdrawn director's loan account be struck off?

If a company has an overdrawn director's loan account, it is likely that there will be monies due to HMRC or other creditors. If a director applies to strike off the company it is likely that one of the creditors will object and the striking off will not proceed. If there are no objections the company may be dissolved, but creditors may apply to court to have the company reinstated and appoint a liquidator to seek repayment of the loan. In addition, the government can investigate the affairs of dissolved companies and take action against the directors.

How DLA transactions are treated in insolvency

Henderson Loggie

1

Salary/Wages

A director's salary/wages are paid to a director under an employment contract and processed through the company's payroll scheme. These typically do not feature in a DLA, unless there is an amount unpaid, in which case may be included as a credit in the DLA (effectively as money loaned to the company).

2

Drawings

Drawings are amounts withdrawn by directors which are not salary/wages or business expense repayments. It is common for directors to take out money as drawings rather than salary/wages for beneficial tax planning reasons. Drawings reduce any DLA credit balance.

It is inappropriate for directors to reclassify any prior drawings as salary ahead of any insolvency event. This will likely be challenged by the Office Holder in an insolvency and considered director misconduct. Any misconduct reported to the Insolvency Service could lead to the disqualification of directors.

3

Shareholder dividend offset

In the ordinary course of business, where funds are not readily available to a director to repay an overdrawn DLA balance and the directors are also shareholders of the company, it is possible for company profits to be used to declare dividends which can be offset against the DLA balance to reduce or clear the amount which is due by the directors.

Where there is a risk of insolvency, however, the company may no longer be generating profits and any retained profits are likely to have been eroded. In these circumstances, the company would be unable to declare dividends to offset against drawings leaving the director personally liable to repay the overdrawn DLA balance.

4

Considerations for directors

It is important for directors to be aware of the company's financial position and understand how their drawings compare with money they've loaned to the company.

If there is any concern, a director could look to protect their position by taking future payments as salary/wages (provided salary/wages could not be deemed excessive for the role the director performs). Although this could be more costly for the company overall, it may be necessary for directors to avoid exposure to personal liability.

Alternatively, the director could stop drawing funds from the company altogether.

Phoenix Companies: re-use of Company names

Henderson Loggie

Companies can face insolvency for all sorts of legitimate reasons. Directors can set up a new company to carry on a similar business, providing they are not personally bankrupt or have been disqualified to act as a director. They must also ensure the reasons for liquidation have been identified and addressed. However, they cannot use the same company name, or one so similar that it suggests an association, as insolvency law restricts the use of the insolvent company's name.

As the name suggests, a phoenix company is the term use to describe another company that rises from the ashes of an insolvent one. Phoenixing is the practice of transferring an insolvent company's business to a new business thus carrying on trading but leaving the debts behind. The insolvent company often then enters into liquidation or is eventually struck off.

There have been instances , hopefully now in the past, of directors who are serial phoenixers, setting up new companies repeatedly, to leave the debt in the old companies. Customers and creditors are often not aware they are trading with a new company as they are dealing with the same people and the company names are so similar.

Sections 216 and 217 of the Insolvency Act 1986 address this problem by restricting the re-use of insolvent company names.
S. 216 :

- Applies to persons who were directors, or shadow directors, in the 12 months prior to the company going into insolvent liquidation.
- The name is prohibited if it was the name the liquidated company was known by during those 12 months or is so similar that it suggests an association
- Unless permission is granted, following application to Court, the person cannot directly or indirectly be associated with another company known by a prohibited name for 5 years from the date of liquidation.

S. 217 sets out the consequences . A person who has contravened S. 216 and is involved in the management of the company can be held personally responsible for all the debts and other liabilities of the company incurred during their involvement. This is joint and several liability with any other liable person. And for those who think they will get around this by acting as a shadow director, the same penalties apply to anyone who acts on their instruction in the knowledge that they are circumventing the use of a restricted name, so both parties will then be liable.

In addition, the person could be prosecuted and if convicted, imprisoned and/ or fined, may be disqualified as being a director and may have assets confiscated as proceeds of crime.
The restricted name is not confined to the company's registered name but also includes trading names, brand names, registered trademarks, and as previously noted, any name so similar that it suggest an association with the liquidated company.

There are three exceptions to this rule:

- The name may be used if the insolvent company is sold by the Liquidator/ Administrator, and you give the required legal notice that you intend to be a director or involved in the management of the business using the prohibited name.
- You can apply to court for permission to use the name. This must be done strictly within 7 business days of the company going into liquidation.
- If you are already involved with a company which has been trading and using the same or similar name continuously for at least 12 months immediately prior to the date of liquidation

Henderson Loggie

How can we help?

As you can see there are lots of things to consider when facing insolvency.

Our Henderson Loggie insolvency team has decades of experience advising businesses, the majority of that time dealing with businesses facing some form of financial difficulty. Most businesses face financial challenges at some point and our team provide support to directors, business owners and individuals in assessing the options.

We can support you with:

- Managing cashflow
- Debt recovery
- Advice for Directors
- Implement Members' Voluntary Liquidations
- Solution implementation
- Creditor support
- Specialist insolvency advice
- Formal insolvency appointments

Get in touch

We know that there can be lots of distress in the unknown of...

Our process:

With your consent, we'll make a quick one-off telephone call to you so that you can get expert advice directly from us.

- You tell us when to call so that we don't disturb you.
- The call is free
- You won't be obligated to do anything following the call

Aberdeen 1 Marischal Square, Broad Street AB10 1BL T: 01224 322 100
Dundee The Vision Building, 20 Greenmarket DD1 4QB T: 01382 200 055
Edinburgh The Stamp Office, Level 5, 10-14 Waterloo Place EH1 3EG T: 0131 226 0200
Glasgow 100 West George Street G2 1PP T: 0141 471 9870

Henderson Loggie LLP is a limited liability partnership registered in Scotland with registered number SO301630 and is a member of PrimeGlobal, a global association of independent accounting firms, the members of which are separate and independent legal entities. Registered office is: The Vision Building, 20 Greenmarket, Dundee, DD1 4QB. All correspondence signed by an individual is signed for and on behalf of Henderson Loggie LLP. Reference to a 'partner' is to a member of Henderson Loggie LLP. A list of members' names is available for inspection at each of these addresses.