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PERSONAL BANKRUPTCY AND LIQUIDATION OF A COMPANY

INFORMATION FOR PEOPLE IN BUSINESS AND THEIR ADVISERS

Disclaimer: The material contained in this publication is not made available for the purpose of rendering professional advice. Users should seek independent professional advice in relation to their particular circumstances.

Many people operate their business through a company, seeking to avoid personal liability for the company's trading debts and to protect their personal assets if the business fails.

If the company cannot pay its debts, and you can't either, a consequence could be that the company goes into liquidation and you may become bankrupt.

It is important to understand what is involved in bankruptcy and liquidation and how they interact.

If you operate a business through a company, the company owns the assets of the business and is liable for any debts incurred. You, as a director or shareholder, are not generally personally liable for the company's trading debts and other liabilities.

However, banks or suppliers may require you to give a personal guarantee against any unpaid liabilities of the company. The effect of this is that, if the company cannot pay, you can be legally responsible to pay under the guarantee.

In a situation where the business is not doing well, both the company, and you, may come under financial pressure from creditors demanding payment.

Further, if you are a company director and the company has difficulties paying its debts when they are due, it is important that you seek appropriate professional advice and act on that advice. If the company continues to trade and incur debts that it can't pay when they become due, you may become personally liable for those debts; regardless of whether you gave a personal guarantee or not.

Part A of this guide provides information for business people in that situation.

Part B provides more detailed information for them and their advisers.

PART A – GUIDANCE FOR THOSE IN BUSINESS

Some initial basic information

You can become bankrupt in one of two ways:

- either by your own choice (voluntarily) by way of a 'debtor's petition'; or
- as a result of a court ordering that you go bankrupt, on the application of one of your creditors (through a creditor's petition).

When you become bankrupt, a trustee in bankruptcy is appointed. A trustee is a qualified and registered person responsible for administering your bankrupt estate.

Your company can go into liquidation in one of two ways:

- either by a resolution of the shareholders, by way of a 'voluntary liquidation'; or
- as a result of a court ordering that your company be wound up; usually based on a creditor's wind up application filed with the court. This is called a court liquidation.

When your company goes into liquidation, a liquidator is appointed. A liquidator is a qualified and registered person responsible for administering the liquidation of your company.



If you go bankrupt, what happens to your company?

If you become bankrupt, you cannot continue as a company director. Also, any shares you own in the company pass to (or 'vest' in) your trustee in bankruptcy. You no longer own the shares. It is up to the trustee as to what action he or she takes concerning any interest you had in the company.

Depending on the circumstances, the trustee may have the company put into liquidation or sell the shares if they think they can realise money to pay creditors of your bankruptcy.

If the trustee does place the company into liquidation, you have an obligation to assist the liquidator and provide information to them about the company's property, dealings and affairs.

The trustee may decide not to take any action if the company has no assets or there is little or no value in the company. If this occurs, a creditor may apply to court asking that the Court put the company into liquidation and appoint a liquidator.

Bankruptcy has serious consequences and you should seek trustworthy advice if you are considering it.



If your company goes into liquidation, what happens to your personal liabilities?

If your company is put into liquidation, responsibility for administering the company passes to the liquidator. As a director you must assist the liquidator and provide information to them about the company's property, dealings and affairs. However, you are no longer in control of the company.

It is up to the liquidator as to how the liquidation proceeds.

Unless you are bankrupt, you will remain liable for your separate personal debts (for example, your personal credit card) and any company debts that you guaranteed. You will remain responsible for any debts that you may owe to the company, for example, to repay a loan received from the company.

The liquidator will investigate the company's business, property and affairs. This includes determining if any assets exist that are worth recovering for the creditors' benefit. They will also look to see if a claim exists against you as a director; including for:

- failing to prevent the company from trading and incurring debt while insolvent, and
- breaches of director's duties.

They will also investigate whether there are any transfers of assets that can be recovered for the creditors' benefit.

If you do not become bankrupt, the company's liquidation only resolves the company's indebtedness to its creditors - it does not resolve your separate personal debts or guarantees.



Get the right advice

Business failure can result in legally complicated outcomes, including potential asset recovery actions and penalties against you if you do not comply with your legal obligations.

You should consult an appropriately qualified specialist insolvency accountant or lawyer, a financial advice service, a registered trustee (about your personal financial situation) or a registered liquidator (about your company's financial situation) as soon as possible if you suspect that you or your company cannot pay debts when they are due.

Often, a registered trustee or registered liquidator will meet with you, at no cost, to provide preliminary advice on your options. However, it is important to know that, once appointed, a liquidator or trustee does not act for you personally or your adviser – they act for the benefit of your creditors or your company's creditors.

Be wary of untrustworthy advisers

Certain advisers target individuals or company directors whose businesses or individual circumstances may be in financial distress and suggest that they take actions which could be illegal (such as suggesting you transfer assets to another person or company without that person or company paying for them).

These actions can lead to serious consequences for individuals and company directors, including large fines or even imprisonment. It is important you know what you are paying for and that the advice you are given does not cause you to break the law or breach your duties.

Some of the warning signs of untrustworthy advisers to look out for:



They may contact you out of the blue.



They may suggest you transfer assets owned by you, or your company, to another person or company without that person or company paying for them. This can damage the claims of your or the company's creditors.



They may be reluctant to provide their advice in writing. You should always ask for any advice to be provided in writing so you have a record of it.



They might tell you they use a 'friendly' trustee or liquidator. However, by law a registered liquidator or trustee, if formally appointed to externally administer your company or administer your bankrupt estate, cannot act for you personally or your adviser. They must only act on behalf of the creditors.



They may tell you to withhold or delay providing your records to your trustee or the company's books and records to the liquidator. This is an offence.

If an unknown adviser, or your existing solicitor or accountant, suggests you take actions which you aren't sure of, you should seek a second opinion from an independent and appropriately qualified specialist insolvency accountant or lawyer.

PART B - INFORMATION FOR BUSINESS PEOPLE AND THEIR ADVISERS

This part explains, for advisors, the legal and other consequences and options if your client is a company director and owns shares in a company.

Your client is a director and owner of company shares and goes bankrupt

If your client becomes bankrupt, most of their property passes to (or 'vests' in) their trustee in bankruptcy. That property includes your client's shares in their company and any amounts the company owes your client. The Trustee will replace your client as a shareholder in the company.

The trustee will assess what the company owns, its liabilities, and what interest the bankrupt estate has in the company. This interest also includes any money that the company might owe to your client.

If the company is able to pay all of its debts and owns valuable property, the trustee may decide to realise this value so the funds can be returned to shareholders (including the bankrupt estate). These funds would be used to partly or fully pay out creditors in your client's bankruptcy.

If the company is insolvent, with liabilities and assets, it may still be necessary to have the company put into liquidation to recover money owed by the company to your client. But if your client's company is assetless and or dormant, the trustee may decide to do nothing, or to disclaim the shares.

Your client generally has no legal obligation to pay the company's creditors unless:

- they have given a personal guarantee to one or more of the company's creditors
- are found by the court to have breached a duty as a director
- are found by the court to have not taken adequate steps to prevent the company from incurring debts while it was insolvent.

Any claims against your client at the date of bankruptcy will generally become claims in their bankrupt estate.

From the moment your client becomes bankrupt and for the period of their bankruptcy, the Corporations Act prevents them from being a director of any company. Their ability to exercise any of the powers as a director also ends. It is an offence if your client continues to act, formally or informally as a company director.

As a former director, if a liquidator is appointed to the company, your client has responsibilities to the liquidator which continue even though your client is bankrupt. This includes an obligation to assist the liquidator.

If other people also own shares in the company, for example, your client's business partner or spouse, the same principle applies. Although the trustee may need to deal with those shareholders in selling your client's shares in the company or to have the company put into liquidation.

If your client is the sole director and shareholder of a company, they may be asked to assist their bankruptcy trustee in sorting out the company's affairs and may need to explain how the company conducted its business. They may need to sign documents for the trustee.



Your client's company has failed but your client does not go bankrupt

If your client is solvent, but their company has failed, your client should seek advice from an appropriately qualified specialist insolvency accountant or lawyer as soon as possible, on whether they should voluntarily put their insolvent company into liquidation or administration. Alternatively, a creditor may apply to the court to have the company put into liquidation.

Once the company is put into liquidation, (with the liquidator now controlling the company), your client generally has no personal liability for the company's debts, unless:

- they provided a personal guarantee to any of the company's creditors,
- are found by the court to have breached a duty as a director
- are found by the court to have not taken adequate steps to prevent the company from incurring debts while it was insolvent

The liquidator may also bring action against your client to recover company property disposed of in breach of their duties or to recover compensation for the loss creditors incurred as a result of insolvent trading.

As a director, your client must assist the liquidator in various ways; including providing information about the company's property, dealings and affairs and delivering the company's records to the liquidator.

Just because your client's company is put into liquidation does not mean they can't set up another company and continue with another business. However, if your client does this, they should ensure they do not:

- breach their duties to the liquidated company as a director, or
- move assets away from the liquidated company at less than their value.

If your client breaches their duties or removes assets, they can be prosecuted and the assets recovered.

The liquidator must investigate the company's affairs and may ask questions of your client about its affairs and transactions. If your client does not assist the liquidator, they can be prosecuted and disqualified from acting as a company director.



MORE INFORMATION

See the ASIC, AFSA, and ARITA websites:

www.asic.gov.au
www.afsa.gov.au
www.arita.com.au