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Newman & Partners

Licensed Insolvency Practitioners

RECOVERY & REVIVAL BULLETIN

Welcome to the latest issue of our Recovery and Revival Bulletin, designed to keep you up-to-date on insolvency matters that may be of interest to you. If you have any feedback on this bulletin, or would like to know more about our services or how we can help you, please contact us on **020 8357 2727** or at **insolvency@newmanandpartners.co.uk**

The dangers of insolvency avoidance – How to stay compliant

When insolvency is looming, it is natural for directors not to want to accept the reality that their business may be about to close. It can result in some erratic behaviours that need to be cautioned against by anyone in a position to offer support and advice. There comes a point where it is not possible to fight against insolvency and it is better to accept the reality that businesses sometimes have to close. Not all advice offered during this challenging time is good, so it is best to understand what obligations directors have in this time and how they can stay compliant.

What are the dangers of insolvency avoidance?

Engaging in insolvency avoidance can be illegal if it is based on inaccurate advice or fraudulent rescue schemes. This is not to be confused with the idea of avoiding insolvency by changing the fortunes of a business through legitimate means. The real danger comes when insolvency avoidance is attempted despite insolvency being assured.

The Government recently had to disqualify two individuals for the role that they played in assisting businesses with insolvency avoidance when doing so was neither ethical nor legal. They were part of a scheme wherein struggling businesses were sold rather than going through liquidation. The declared assets of the companies were not handed over to the two businesses implicated in the avoidance scheme, suggesting that the transactions were illegitimate.

Both have facilitated the Atherton corporate rescue scheme by becoming directors of a combined 138 struggling companies without independently verifying their financial positions, failing to look into the location of more than £42 million in assets and leaving creditors with combined debts exceeding £67 million. This resulted in them both receiving seven-year bans, with the pair agreeing to the ban to avoid the case appearing in court.

Rather than enter formal insolvency proceedings, the distressed company directors transferred ownership to the two individuals.

These individuals then left the companies to be liquidated or struck off, ensuring that creditors faced the financial fallout rather than the directors who had been responsible for the downfall of the businesses. As the Atherton scheme was seen as a way for directors to abdicate their own responsibilities, it was deemed unlawful.

What was the Atherton Scheme?

To understand the implications of what unfolded, it is necessary to understand the extent of the issue. The Atherton Scheme involved directors paying for a company rescue scheme wherein they would transfer ownership to a new director and forgo responsibility. It is reported that the *fee was anything up to £15,000*, which, when the sheer number of companies involved in the scheme is taken into account, would have resulted in the participants making a significant amount of money.

The aim of the scheme was to put enough time and distance between the original director and the insolvency to ensure that reputational damage and fiduciary responsibility could both be avoided. As such, the interim director did little to manage each acquired business, instead letting the clock run down until they were eventually struck off or liquidated.

While initially seeming to be an abandonment of duty, the scheme may be an example of wrongful trading as the directors technically sold the business when it was insolvent. While the fee was nominal and likely not anything close to the true value of the company, the fact remains that money and ownership changed hands, creating legal exposure.

What does the insolvency avoidance scheme teach?

The main takeaway from this scheme being shut down is a timely reminder that insolvency avoidance is dangerous and that one cannot avoid legal duties and obligations.

The individuals involved have been banned from being involved in the promotion, formation or management of a company without the permission of the court. This is the fate that awaits directors who neglect their responsibilities when a business is going insolvent.

Insolvency avoidance schemes are generally unlawful to pursue as they explicitly involve bypassing insolvency practitioners. Other harmful practices can arise as a result of insolvency avoidance schemes, such as the much-maligned practice of phoenixism.

In this instance, hastily disposing of a business for only a nominal fee is a clear indicator that the scheme was less than legitimate.

Even when overseeing a distressed company, a director must still uphold their statutory duties. They cannot rely solely on assurances from intermediaries or future directors and should seek independent professional advice before committing to any action. Transferring ownership at that late stage can be seen as a way of retaining and diverting assets out of the line of fire from insolvency proceedings while working to abandon debts. The reality is that directors are being misled, believing that they can walk away from financially distressed businesses without fulfilling their obligations.

For directors who are facing down insolvency proceedings, it is best to keep a level head and understand what is within their power to control and what they cannot do. This is where seeking the advice of a respectable advisor becomes imperative, for there will be plenty of less scrupulous advisors around encouraging directors to partake in unethical and illegal activity.

If your client is in a position where they are receiving advice that seems to be too good to be true, then it likely is. If they are being advised to move assets out of the reach of an insolvency team, they should be aware that this will be detected and punished accordingly.

While insolvency proceedings are often viewed with fear or suspicion, directors would do well to remember that they are designed to resolve difficult financial circumstances in a way that is best for everyone. The aim of insolvency is to try to reduce the ultimate financial loss for as many parties as possible and provide directors with a dignified exit from the business. Attempts to defy the process will bring legal action where none may have been required otherwise.

We provide specialist advice to ensure that you can guide your client through the specifics of their situation so all involved can be assured that they are engaging with the best course of action. Our experts can help to determine when insolvency is right for a business and will help illustrate to directors the options available to them.

If you or a client is unsure about insolvency, *please speak to our team of experts*.

What can be done to tackle phoenixism?

In the news once more recently, phoenixism is a prolific problem that threatens the integrity of insolvency practices. Phoenixism is the practice of liquidating a company only for the same directors to begin trading again with a new entity, now free of liabilities. Understandably, the idea that directors who oversaw the financial ruin of a business immediately leap into a new venture is not one that sits well with those who conduct themselves properly. This raises the question of whether anything can be done to stop phoenixism.

What is the impact of phoenixism?

Beyond the general sense of the practice being unfair to those who do follow the rules, there is a deeper issue with phoenixism. HMRC estimate that the practice costs the taxpayer £800 million every year. Disturbingly, the practice does not seem to be diminishing and new examples of phoenixism seem to keep emerging.

A lot of phoenixism is heavily tied to prepack administrations. Through these, where staffing firms are 'acquired' but continue trading partly under former owners or managers. In some cases, those involved repeat the cycle across multiple companies.

Phoenixism is often justified under the guise that the remaining owners did not have substantial control when the company went insolvent and that their knowledge of the business is beneficial. While some business owners are able to get a fresh start with a new business and trade in a perfectly legal manner, it is difficult to deny the role of ego in phoenixism and the cost to the taxpayer cannot be overlooked.

As 22 per cent of the tax losses reported in 2022/23 are attributed to phoenixism, it is hoped that HMRC may take the matter more seriously going forward. However, to achieve this, it may be necessary to overhaul the current approach to insolvency.

How can phoenixism be stopped?

Out and out phoenixism is strictly illegal to prevent business owners from intentionally using and abusing the insolvency process for their own gain. However, there is grey area still being exploited.

Phoenixism is currently curbed by *Section 216* and *Section 217* of the Insolvency Act 1986, which apply restrictions to the reusing of company names and position the liability of debts respectively. Yet, given the continued persistence of the problem, it may be felt that the measures do not go far enough.

Recent changes to Companies House brought about by the *Economic Crime and Corporate Transparency Act 2023* are a clear indication that HMRC are looking to crack down on fraudulent business dealings. It may be that future expansions of Companies House powers, of which more are coming, though not specifically confirmed, could go some way to directly tackling the problem.

While it is not legal to use similar company names for five years, there is very little to prevent directors from banding together under a new label. This is not to say that starting anew is always an issue, but a clear distinction must be drawn between getting a fresh start and engaging with phoenixism.

If phoenixism is to be combated, it will need to place people under greater scrutiny while still maintaining a focus on corporate entities. If you or your client is concerned about trading following insolvency without engaging in phoenixism, then we can help you.

Establishing a new business when a former one has gone insolvent is not inherently problematic, but it must be managed properly.

For tailored, expert advice about insolvency, *please speak to our team of experts*.

Supreme Court clarifies liability for fraudulent trading under the Insolvency Act – What's the impact?

While you are likely aware that your clients have responsibilities in how they operate when insolvency proceedings are the best course of action, you may not have registered the role that third parties play in proceedings. *The Insolvency Act 1986* recently received an important clarification due to a ruling from the Supreme Court and it is essential that the implications are understood.

What has the Supreme Court clarified with the Insolvency Act?

It has been a long-held view that the liability for fraudulent trading was the responsibility of directors and those managing the business. However, the Supreme Court has broadened the interpretation of Section 213 of the Insolvency Act to expand responsibility. Any third parties knowingly dealing with fraudulent businesses will now also be at risk.

This is significant news for any accounting teams that are engaged in work with businesses in difficult financial circumstances. Where before there was an argument that teams could plead ignorance about the business dealings they were supporting, accountants are now at risk of facing consequences for not raising concerns.

For accounting teams, the change mirrors other responsibilities to not work with businesses that are engaged in unethical or illegal practices. As it is not lawful to work with a business that you know is actively laundering money, you should view insolvent businesses through the same lens. To stay on top of your legal responsibilities, you should know at what point in the insolvency process a business would be conducting fraudulent activity.

When do insolvent businesses begin fraudulent trading?

When it is clear that a business is incapable of paying off its liabilities, then it has no choice but to go insolvent. At this point, it is illegal to continue trading, as this will incur greater liabilities and make the situation significantly worse.

Directors may, at this juncture, attempt to engage in other unsavoury practices to avoid paying the full amount of liabilities owed. It is any assistance with these practices, as well as with a business that is operating while insolvent, that is the scope of the Supreme Court's new interpretation. It was observed by the Supreme Court that nothing in the language of Section 213 restricted the law to solely focus on directors and insiders. Instead, third parties could be considered as an accessory to the fraudulent trading provided they engaged with the company when it was not legal to do so and had sufficient knowledge of the insolvency of the company.

This naturally opens the door to accountants being exposed to risk when working alongside insolvent companies. It would be a significant challenge to argue that the very people responsible for handling the finances of a business would not know that its debts were insurmountable.

How will the Supreme Court ruling shape future insolvency practices?

It seems that many experts are unsurprised by the clarification and that the real point of interest is that such a clear understanding of a decades-old law has taken so long to manifest. It is not outside the realm of legal responsibility for accountants and other third parties to do due diligence on the kinds of businesses they work with. In the same way that assisting a criminal organisation exposes one to legal culpability, so too does working alongside an insolvent business.

There is a view that the expansion of the interpretation may also expand the reach of insolvency practitioners to reclaim funds to pay off creditors. Insolvency practitioners may now have grounds to pursue third parties when tackling fraudulent trading and could recover funds through this process.

Harmful practices around insolvency can be harmful for the wider economy and for businesses more generally. That is why we work to uphold the highest standard for insolvency practices and educate those who would benefit from such knowledge.

We support accountants and businesses alike in getting a better understanding of insolvency practices.

For tailored, expert advice about insolvency, *please speak to our team of experts*.

CAREFUL CONSIDERATION IS NEEDED BEFORE TAKING OUT ANY FORM OF FINANCE AND SPECIALIST ADVICE SHOULD BE SOUGHT. IF YOU HAVE ANY QUESTIONS, PLEASE CONTACT US.

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