

Dissolution loophole set to be closed

Closing the door on director misconduct



New legislation, which aims to prevent company directors avoiding investigation into their conduct by informally striking off their company instead of entering an insolvency process, has had its first reading in Parliament and looks set to become law by the end of 2021.

The move has been driven, in part, by the fear that some directors will look to avoid repayment of government-backed funding, such as CBILS or Bounce Back Loans, by dissolving their company instead of placing it into a formal insolvency process such as liquidation.

Dissolution and avoiding investigation

Currently, only live companies, or those that enter a formal insolvency process, can be investigated by the Insolvency Service for allegations of fraudulent trading. Directors can face a number of penalties and sanctions if found guilty of misconduct, including being made liable for company debts or being disqualified from acting as the director of a limited company for up to 15 years.

Dissolving a company through the strike-off process is not classed as a formal insolvency procedure and, therefore, directors can avoid investigation if they can successfully close their company in this way. The dissolution process is designed for companies which are not threatened with an insolvency procedure and haven't been trading for the preceding three months, some directors have been using this as an alternative to formally liquidating their company.

This law, if passed, will not only prevent directors from dissolving companies with active liabilities going forward, but it is also set to be retrospective. This means the Insolvency Service will have the power to investigate companies that have already been dissolved but with a government-backed coronavirus loan still outstanding.

Closure, rescue, and recovery options

For a company with existing liabilities – whether this is a government-backed Covid loan or not – formal liquidation is the optimal closure route for all concerned. Not only does liquidation ensure outstanding creditors are treated fairly, but it also demonstrates a desire on behalf of directors to adhere to their legal obligations once they become aware their company is insolvent.

If the company has a viable future despite any current challenges, there are a range of rescue and recovery processes which can be explored if there is a desire to turn around the company's fortunes. This can take the form of a Company Voluntary Arrangement (CVA) which facilitates negotiation with outstanding creditors, or Administration, which provides breathing space while a restructuring of the business is executed.

Further information

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