JBC Corporate

Director's Liabilities for Company Debts

The areas of potential liability for a director are:

- Insolvent trading compensation claims;
- Unreasonable director-related transactions;
- Loss of employee entitlement claims;
- PAYG taxation debts and superannuation contributions; and
- Personal guarantees.

Insolvent Trading

Insolvent trading occurs when a company incurs a debt that it cannot and does not pay, at a time when a director knew, or should have known, that the company was insolvent. Directors have a duty to prevent insolvent trading under section 588G of the Corporations Act, and a director becomes liable to pay an amount of compensation equal to the amount of the debt.

What are the Defences Available to Directors – Insolvent Trading

Section 588H of the Corporations Act sets out the available defences. Directors will not be liable if they can establish one of the following:

- They had reasonable grounds to expect that the company was solvent;
- They did not participate in management of the company, due to illness or some other good reason; or
- They took all reasonable steps to prevent the company from incurring the debt.

Unreasonable Director related Transactions

A director-related transaction includes:

- Payments of money made by a company;
- Conveyances, transfers, or other dispositions of company property;
- Securities issued by the company; or
- Incurred obligations to make such transactions.

To be 'director-related', a transaction must involve either:

- A company director;
- A close associate of a company director; or
- A 'nominee' acting on behalf of, or for the benefit of, a director or their close associate.

What Makes a Transaction Unreasonable?

A transaction is unreasonable if a reasonable person in the same circumstances as the company would not have entered into the transaction after considering:

- Any benefits that the company may have obtained;
- Any detriment the company may have suffered;
- Any benefits that other parties to the transaction may have obtained; or
- Any other relevant matters.

If a reasonable person who would not personally benefit from the transaction would not have entered into that transaction, the transaction is likely to be 'unreasonable'. A liquidator may claim the amount of loss suffered by the company as a result of the director entering into the transaction.

Loss of Employee Entitlement Claims

Liquidators and employees have a right to claim against a director if a company entered into a transaction that reduced the amount of assets available to pay priority employee entitlements in a liquidation. These transactions are known as agreements or transactions to avoid employee entitlements.

What Amounts to a Contravention of the Corporations Act – Employee Entitlement Claims

Section 596AB of the Corporations Act states that:

A person must not enter into a relevant agreement or a transaction with the intention of, or with intentions that include the intention of:

(a) preventing the recovery of the entitlements of employees of a company; or

(b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.

Directors contravene the Corporations Act if they intentionally cause a company to enter into one of these agreements or transactions. A contravention of section 596AB activates section 596AC and gives the liquidator the right to make a recovery claim. This claim will be the amount equal to the loss caused by entering the transaction.

Taxation Debts

Directors are personally liable if a company fails to remit PAYG withholding tax or superannuation contributions by their due dates; however, personal liability can be avoided in certain circumstances. Directors may also be liable if the ATO needs to refund monies to a liquidator under the unfair preference provisions in section 588FGA of the Corporations Act.

Personal Guarantees

A personal guarantee is a separate third-party agreement between the guarantor (a director) and a creditor, where the guarantor agrees to pay company debts, usually in full, when they have not been paid. The validity of personal guarantees is not disrupted by the actions of liquidators or administrators. Generally, a creditor does not need to take any specific action to make a guarantor liable. However, a personal guarantee cannot be exercised while a company is under voluntary administration. Once that period ends, the guarantee can be exercised immediately.

Should you have any questions or require further information on this subject please don't hesitate to get in touch.

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