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Directors Liabilities

Directors can be liable for company debts, even when the directors have taken some remedial action in an attempt to solve the company's financial problems.

The areas of potential liability for directors are:

1. Insolvent trading compensation claims
2. Unreasonable director related transactions
3. Loss of employee entitlement claims
4. Taxation debts and superannuation contributions
5. Personal guarantees
6. Breach of Work Health and Safety

☑ INSOLVENT TRADING

→ Section 599G of the *Corporations Act 2001* ('the Act') provides that directors have a duty to prevent a company from insolvent trading.

→ Insolvent trading occurs when a company incurs a debt that it cannot and does not pay at a time when the director knew or should have known that the company was insolvent.

→ The Act provides some statutory defences for directors. Directors will not be liable for insolvent trading if they can establish:

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

To avoid liability, directors must also take care to keep themselves informed about the company's financial position.

→ The liability of the director must be proved by the liquidator or creditor. The liquidator has six years from the date of appointment to commence a recovery action against a director for insolvent trading.

→ There are various penalties and consequences of insolvent trading, including civil penalties, compensation proceedings and criminal charges. For example, a director may be liable to pay compensation equal to the amount of debts incurred while the company was insolvent and remain unpaid at the time of liquidation.

☑ UNREASONABLE DIRECTOR RELATED TRANSACTIONS

→ Directors will be liable if they cause the company to enter into a transaction that may be classified as a director related transaction and was 'unreasonable' when considering the benefit of the transaction to the company.

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→ Such transactions include payment of money, transfer of property, or issue of securities and involve a director or a close associate of a director. The transaction is unreasonable if a reasonable person with no possible personal benefit from the transaction would not have entered into the transaction.

→ Again, the liquidator is responsible for proving the elements of the claim. However, the transaction must have occurred during the four years before the winding up commenced.

→ The claim is for the amount of 'loss' suffered by the company as a result of entering into the transaction. The type of compensation is dependent on the transaction.

☑ LOSS OF EMPLOYEE ENTITLEMENT

→ Under the Corporations Act, a person must not enter into a transaction with the intention of:

i. Reducing the recoverable entitlements of a company's employees, or
ii. Preventing the recovery of their entitlements.

→ A director can be liable to the liquidator, or even the employee personally, if a company has entered into transactions that reduced the amount of assets available to pay priority employee entitlements in liquidation. This aims to protect any entitlements owing to the employee, such as long service leave, as well as superannuation contributions.

→ The amount of any such claim is generally the actual loss caused by entering into the transaction. The loss itself is limited to the amount of priority employee entitlements that cannot be paid as a result of the reduction in available assets caused by the transaction.

☑ TAXATION DEBTS

→ Directors are personally liable if the company fails to remit PAYG withholding tax or superannuation contributions by the due date.

→ On the due date of a payment of tax a director must pay the amount, enter into an arrangement with the ATO or wind up the company. Failing to do one of these things will expose the director to personal liability for a penalty in the amount of the unremitted tax.

→ Directors may also become liable if the ATO has to refund monies to a liquidator under the unfair preference provisions. In this situation, the directors are liable for that amount, plus any costs that the ATO is ordered to pay to the liquidator.

→ Liability extends to being a director at the time of the original payment to the ATO and not just when the company was wound up.

☑ PERSONAL GUARANTEES

→ A director is also liable for any personal guarantees entered into.

→ A personal guarantee is a separate third party agreement between the director (the guarantor) and the creditor, where the guarantor agrees to pay the debts of the company in the case of non-payment.

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→ As the guarantee is a separate agreement between the director and the creditor, the company does not have to be in liquidation, or even insolvent, for the guarantee to be exercised.

☑ BREACH OF WORK HEALTH AND SAFETY REQUIREMENTS

→ The *Work Health and Safety Act 2011* ('WHS Act') imposes personal liability on directors, with substantial penalties being imposed for breaches.

→ Directors have a positive duty to exercise due diligence to ensure the company has arrangements in place to comply with its legal obligations under the WHS Act. The company does not need to have breached the legislation in order for a director to be personally liable.

→ Directors who breach the WHS Act are likely to face prolonged court proceedings, significant fines and criminal convictions.

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