

Insolvency

Sole trader or partner – are you at risk?



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Fact Sheet

Introduction

Nobody likes to think about their business becoming insolvent, but if it does, the personal liability you have for its debts will depend on its legal entity.

This is a question well worth considering when you start a business, if it is growing fast or if you own the business with others. Here is a brief summary of the main options and where you stand.

Unlimited company

Whether you are a sole trader or are in business with others, if you have never registered your company you are probably 'unlimited'.

If the company fails you and your associates will be liable to pay the debts from your personal assets, so your savings and home will be on the line.

It is easy for even a successful business to get into trouble, for example if a large customer goes bust or you overtrade and run out of cash, so seriously consider a 'limited liability' option.

Partnership

Partners have unlimited liability for the debts of the partnership, so if your business did fail and had insufficient funds to pay its creditors, your house and other assets could be on the line.

In theory partners would have to contribute additional funds in line with their agreed share of profits, but if your partners had insufficient funds or fled, you would be liable for all the debts.

This being so, you need to be careful when choosing your business partners and to have proper agreements in place, such as a limit on an individual partner's financial authority.

Limited liability partnership (LLP)

This gives you a measure of protection for your personal assets, as specific provisions provide limited liability if the business becomes insolvent.

Members' withdrawals in the two years leading up to the winding up of the business can be clawed back if they should have known the LLP was going into insolvent liquidation.

You are also liable to contribute assets if you have traded fraudulently or you have agreed to do so in the limited liability partnership agreement.

Limited company

This offers a good level of protection for your personal assets. If your business fails you will only be liable to contribute up to the amount you agreed to contribute in share capital.

There are exceptions. If you traded fraudulently or when you knew the business was insolvent, or if you took out profits knowing the company was in trouble, you could be personally liable.

Setting up a limited company is a straightforward, inexpensive process. The accounting, reporting and management requirements are greater, but in return you will be more secure financially.



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