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Being a director and personal liability (April 2022)

As a general principle, because a company is a separate person in law its directors, shareholders and employees are not liable for its debts and other liabilities. If the company is a “limited” company or a PLC its owners, the shareholders, are similarly not liable.

In rare circumstances, the ‘corporate veil’ that separates the company from its owners can be pierced. This may result in the shareholders being liable for company debts or liable to make a monetary contribution to the company.

Directors’ Duties

Directors owe duties to the company of which they are a director. With one important exception, these duties are now codified in the Companies Act 2006.

Breach of director’s duties

The seven statutory duties are as follows:

1. Act within powers

A director must act within the powers assigned in accordance with the company’s articles of association, and only exercise these powers for their proper purpose.

2. Promote the success of the company

A director must act in a way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. This is expressed to be ‘subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company’ – the one area where the duties are not codified in the Act. The topic of how directors should have regard to the interests of creditors when they know or should know that the company is or is likely to become insolvent is under scrutiny in a recent case on appeal to the Supreme Court. However, the content of the duty to promote the success of the company is still places the interests of creditors as ‘paramount’ towards considering when a director knows that the company is insolvent. Although general for now, the Supreme Court may have more to say about the extent to which creditors’ interests are implicated and when.

3. Exercise independent judgement

A director must exercise independent judgement. There will be instances where a director may delegate certain matters to others with specialist expertise, but the director must exercise independent judgement in deciding to delegate and in whether or not to follow that advice.

4. Exercise reasonable care, skill and diligence

A director owes a duty of skill and care to the company.

A director must exercise the care, skill, and diligence which would be exercised by a reasonably diligent person with both:

- the general knowledge, skill and experience that may reasonably be expected of a person performing the functions carried out by the director in relation to the company; and
- the general knowledge, skill and experience that the director actually has.

5. Avoid conflicts of interest

A director must avoid situations where there is a direct or indirect interest of theirs that conflicts with the interests of the company.

6. Not accept benefits from third parties

A director must not accept any benefit (e.g. a bribe) from a third party. This prohibits the exploitation of the position of a director for personal benefit as a personal benefit could give rise to a conflict of interests for the director, who ought to be considering the success of the company, as well as avoiding conflicts of interests more generally.

7. Declare interests in proposed transactions or arrangements

A director must declare any direct or indirect interest in a proposed transaction or arrangement with the company to the other directors.

Wrongful Trading under Section 214 of the Insolvency Act 1986

Under the wrongful trading provisions in the Insolvency Act 1986, the court may order a director to make a contribution to the company’s assets if it can be shown he/she failed to take every step to minimise the potential loss to the company’s creditors once he or she knew, or ought to have known, that there was no reasonable prospect of avoiding insolvent liquidation or administration.

The burden falls on the insolvency office holder (i.e. the administrator or liquidator) to decide whether or not to bring a claim. If the implicated director can show that they had taken early advice from a suitable professional, as insolvency practitioner or solicitor and acted upon it then they could have a defence for a wrongful trading claim against them.

Joint and several liability of company directors

The Finance Act 2020 makes directors personally liable for tax debts in situations where they have purposely engaged in acts with the intention to avoid paying taxes. This could apply to directors with a track record of corporate insolvency, or where the director's company is anticipating, or is undergoing an insolvency procedure.

Furthermore, directors can be pursued for unpaid taxes when the liability arises or is expected to arise from tax avoidance, tax evasion or a penalty for facilitating avoidance or evasion.

Personal Guarantees

It is common practice for a lender to seek a personal guarantee from a director of a company who is also an owner when considering a loan application by a company in order to give the lender an extra layer of protection. In the instance where a director has provided a personal guarantee, he/she can be held personally liable for an amount the company is unable to repay. As such, directors should be cautious when giving personal guarantees as the effect of this guarantee is that if a company is not able to fulfil its obligations to a lender, the liability will then fall on the director to pay up the company's debts. As expressed earlier, the separate legal personality of a company is what keeps the personal liability of directors separate from the company liability, and so such a personal guarantee would in effect get around this legal protection. If a lender does ask for a personal guarantee, the director should ensure that the guarantee is linked to a specific loan rather than an "all monies" guarantee to limit the extent of the personal liability of the director.

Breaches of legislation

A director can also be held liable for breaches in other UK legislation, including the Health and Safety at Work Act 1974. A director can be subject to an unlimited fine or imprisonment where it is proved that the company committed an offence with their consent or connivance or is attributable to their neglect.

Prohibited names under section 216 of the Insolvency Act 1986

This section of the Insolvency Act 1986 is aimed at preventing the re-use of an insolvent company commonly referred to as a 'phoenix company'. A phoenix company is one that has acquired the assets of the company in liquidation and takes the same name as the Company in insolvent liquidation or one that is so substantially similar that it will confuse creditors of the insolvent company but the acquired company does not assume the insolvent company's liabilities.

For the re-use of name to be valid, a court order is necessary or notice must be given to all creditors of the insolvent company. Failure to comply with these requirements may lead to the directors being jointly and severally liable for the debts of the new company.

Companies House filing

Companies House incorporates and dissolves limited companies, and registers company information, making it available to the public. A director is legally responsible for running the company and making sure information is sent to Companies House on time. This includes:

- the confirmation statement;
- the annual accounts;
- any change in the company's officers or their personal details;
- a change to the company's registered office;
- allotment of shares;
- registration of charges (mortgage); and
- any change in the company's people with significant control (PSC) details.

If a director does not fulfil the above filing obligations within the set time, he/she can be liable for a fine of up to £5,000. A director can also be held liable to the company for any loss caused by the making of a misleading statement or any omission from the filings.

Statutory declarations

A Statutory Declaration is a written statement of fact that is signed in the presence of a:

- a Solicitor
- a Notary of the Public
- a Justice of the Peace
- a Commissioner for Oaths
- a Councillor (Scotland only. Documents on or after 10/12/07)
- any other qualified person

When a company is looking to enter into a Members' Voluntary Liquidation, a solvent liquidation process, a director(s) of the company must make a statutory declaration confirming that the company is able to pay its debts in full within the next 12 months. If a director does not have reasonable belief in the accuracy of the statutory declaration they have made they could be liable for an unlimited fine, or up to two years imprisonment.

Whilst every care has been taken in its preparation, the above information is intended for general guidance only, and does not constitute legal advice.

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