

# A credit manager's guide to the small business insolvency reforms

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**In September 2020, Treasurer Josh Frydenberg announced changes to Australia's insolvency regime aimed at reducing the impact of the COVID pandemic on small business. He described the changes as 'the most significant reforms to Australia's insolvency framework in 30 years'.**

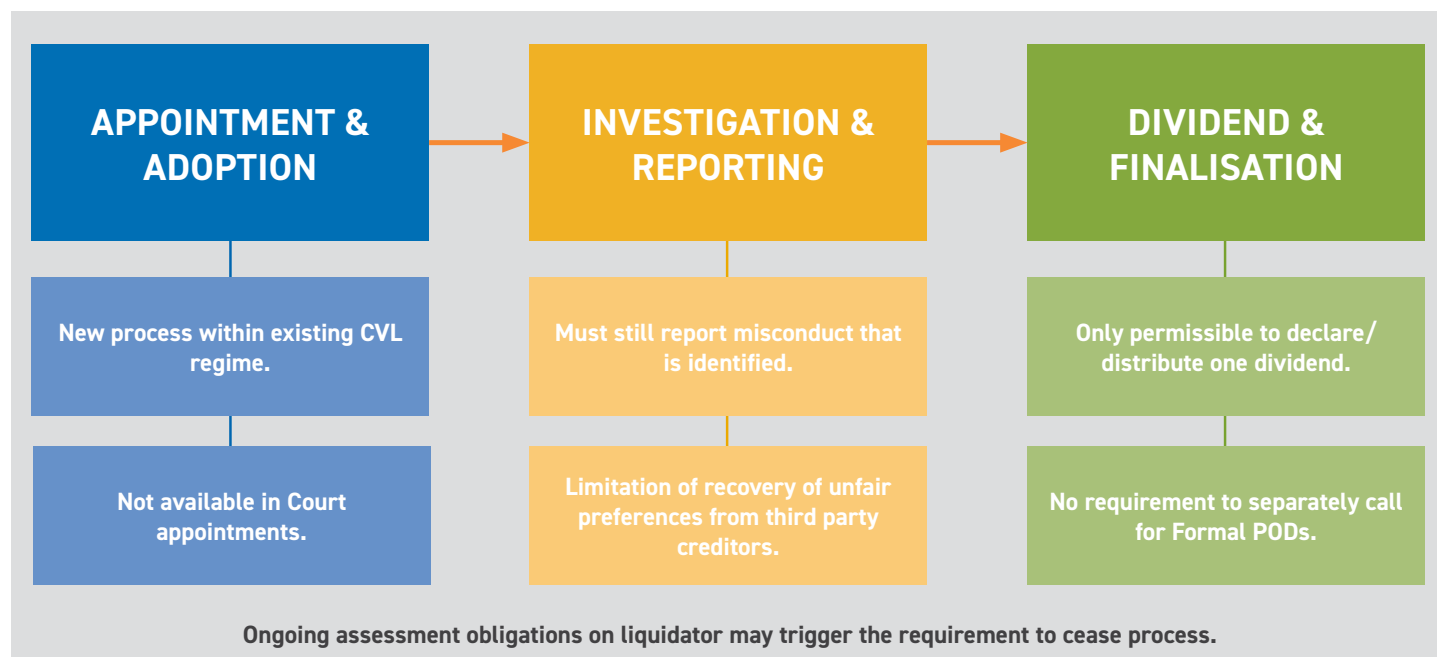
The reforms introduce two new processes, which give small businesses more options to resolve financial difficulties:

- simplified liquidation
- small business restructuring.

## Simplified liquidation

The law provides that a simplified liquidation may be allowed in a creditors' voluntary liquidation for certain eligible companies.

The simplified liquidation is intended to be more cost effective due to reduced investigation, reporting and distribution requirements. However, much of the process remains the same.



### The liquidation process

Liquidation is the process of converting a company's assets into cash, and using those funds to repay, as much as possible, the company's debts. It results in the company being shut down.

There are three different types of liquidation:

- Creditors' voluntary liquidation – is initiated by the company's directors when they are concerned the company can't pay its debts.
- Court liquidation – starts because of a court order, usually made after an application by a creditor of the company.

- Members' voluntary liquidation – is a way for solvent companies (i.e. those not in financial difficulty) to shut down.

Creditors' voluntary liquidation is the most common type of liquidation.

### What are the eligibility criteria?

A simplified liquidation may only be adopted where a company is in creditors' voluntary liquidation and the company:

- will not be able to pay its debts in full within 12 months of the start of the liquidation



- has no more than \$1 million in debts, including amounts for termination of employees (even if they are yet to be terminated)
- is up to date with the lodgement of all returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act 1997*), and
- has not been under small business restructuring or subject of a simplified liquidation process in the past 7 years.

Directors must sign a declaration that the company is eligible.

In addition, the current and recent (acting in the past 12 months) directors of the company cannot also have been a director of a company that has been under small business restructuring or subject of a simplified liquidation process in the past 7 years.

### How is the simplified process adopted?

A liquidator may only adopt a simplified liquidation process within 20 business days of their appointment. There is no guarantee that a simplified liquidation process will be possible, and a liquidator is unable to adopt a simplified liquidation if at least 25% in value of unrelated creditors request them not to, or if they determine the company is no longer eligible.

Adoption can occur ANY TIME within this period if 10 business days' notice has been given to creditors. Once a liquidator has adopted the simplified liquidation process creditors lose the power to object.

It is prudent for creditors, who object to a simplified process being adopted, to object in writing prior to the expiry of the 10-business day notice of intent period. An objection may also be submitted prior to the notice of intention to adopt being sent.

### What has been simplified?

The simplified liquidation process modifies the obligations of the liquidator while they undertake the liquidation. In basic terms it provides for:

- simplified three-month reporting to creditors

- modified recovery of unfair preferences from unrelated creditors (payments within 3 months for amounts over \$30,000)
- modified reporting to ASIC on possible director offences
- modified dividend requirements, including only one dividend being paid
- no meetings of creditors (resolutions must be passed without a meeting – using proposals). However, creditors retain the right to make reasonable requests for information from the liquidator. More information on [creditor rights in liquidations](#)<sup>1</sup> is available on the ARITA website.
- no ability to appoint a committee of inspection or reviewing liquidator (unless appointed by the court).

### Payments to creditors

Like all liquidations, the possibility of a payment to creditors depends on assets being recovered by the liquidator.

As only one dividend may be paid in a simplified liquidation (to any class of creditor), in practical terms this means that the liquidation will need to be close to finalisation before a dividend is declared.

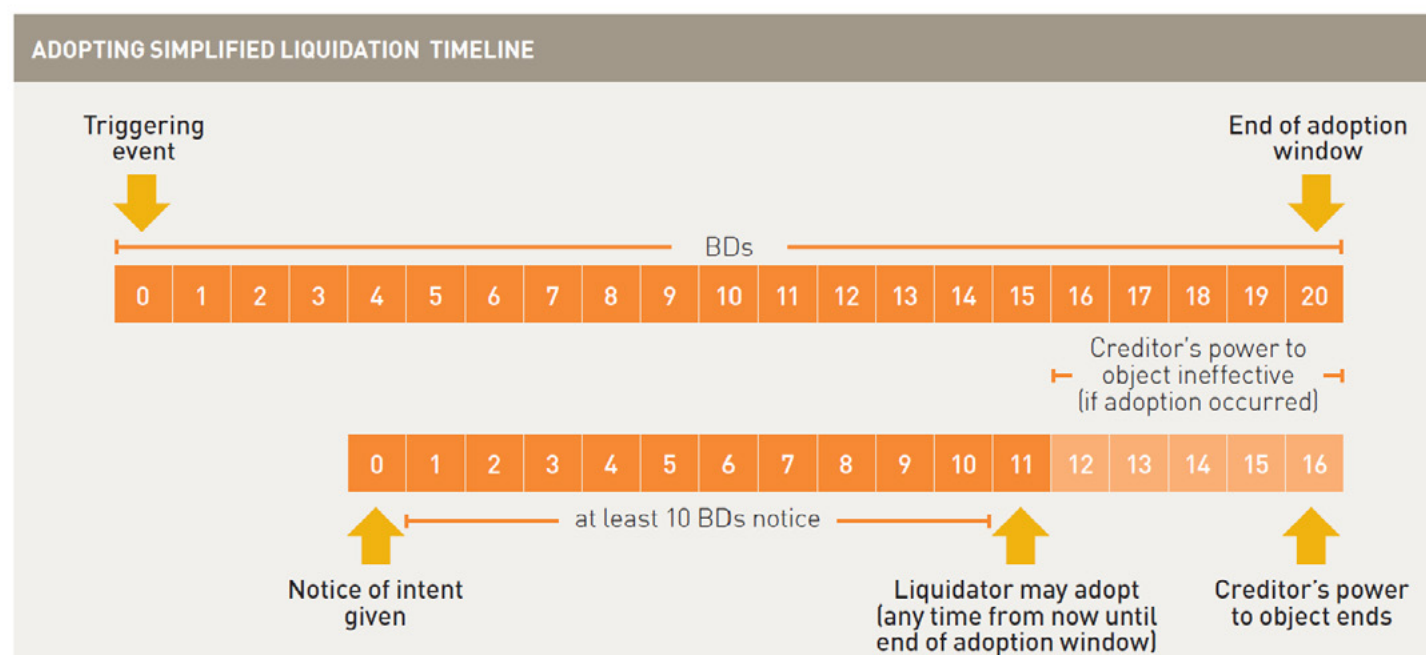
It also means that if a creditor has not proved for that dividend, they will not be entitled to a make-up (or equalising) payment.

### Ending the simplified liquidation process

The liquidator must cease to follow the simplified liquidation process if:

- the eligibility requirements are no longer met, or
- the liquidator believes that the company or a director has engaged in conduct involving fraud or dishonesty which has, or is likely to have, a material adverse effect on the interests of all, or a class of, creditors.

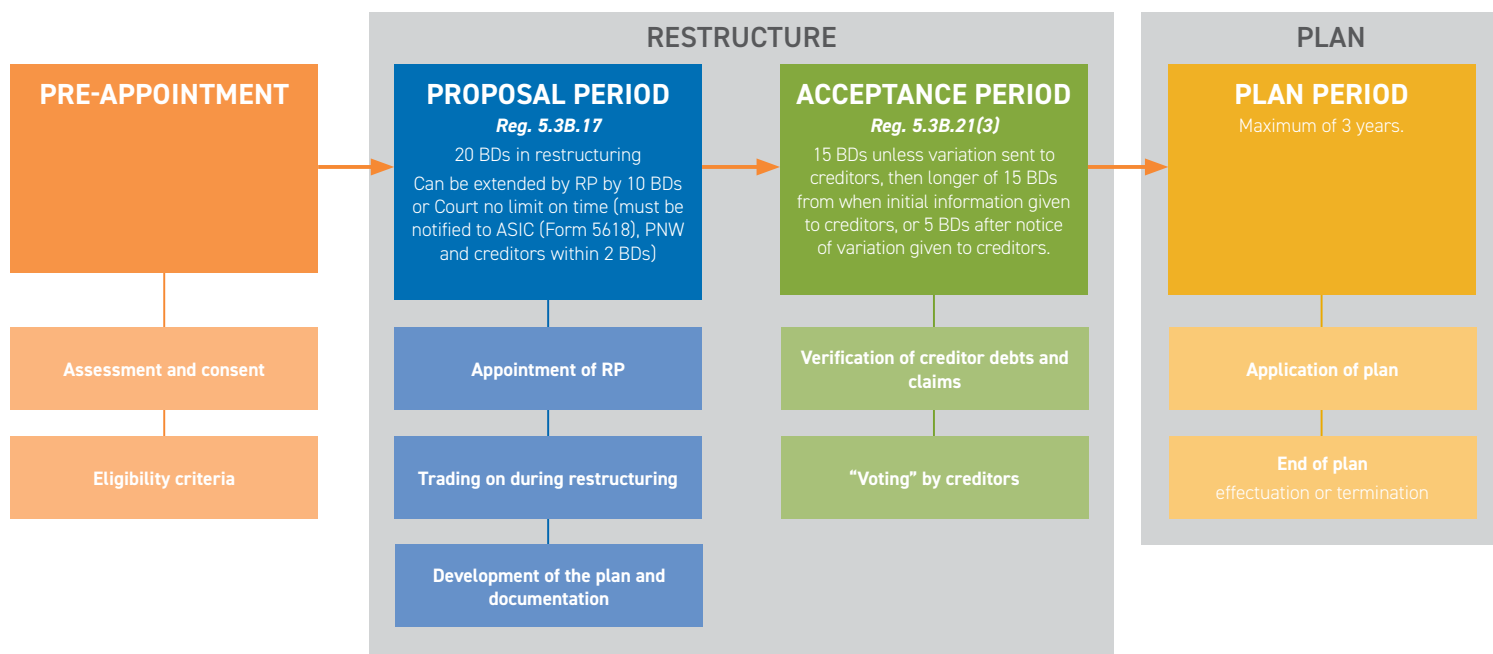
A list of estimated creditors' claims must be included with the initial notification of appointment sent by the liquidator. Creditors should notify the liquidator's office immediately if



## Small business restructuring

The small business restructuring process allows eligible businesses to compromise their debts with their creditors' agreement and maximise their chances of trading profitably in the future. It also allows for business owners to remain in control of their business during the restructuring period.

Directors are assisted through the restructuring process by a restructuring practitioner (RP). A person must be a Registered Liquidator to act as RP for a company.



they disagree with the estimated amount of their claim detailed in the documentation.

### Eligibility

To be eligible a business must:

- be operated by a company
- owe less than \$1 million to its creditors (excluding employees)
- not have previously done a small business restructuring or used simplified liquidation in the past 7 years
- before a plan is offered to creditors, be able to:
  - » pay all outstanding employee entitlements, and
  - » lodge all outstanding documentation and returns with the ATO.

Current and former directors (acting in the past 12 months) must not have been a director of a company that has done a small business restructuring or used simplified liquidation in the past 7 years. Directors will have to sign a declaration that the company is eligible.

### Appointment of the RP

To appoint a RP, the directors must hold a meeting and resolve:

- that the company is insolvent or likely to become insolvent, and
- a RP should be appointed.

The RP is paid a set fee for the restructuring (not the plan) and that is agreed with directors prior to the RP being appointed.

The RP may also ask directors to approve a basis of additional remuneration if they need to undertake court proceedings on the company's behalf. Directors need to agree to that work in writing before the RP can proceed.

Once the RP is appointed, the company must disclose this fact on all public documentation e.g. letterhead, website, cheques, etc. If a small business restructuring is entered into, the directors and the company will be subject to restrictions on the future use of a restructuring process or simplified liquidation for 7 years. This restriction applies to this company or any other company that the directors are, or have been in the prior 12 months, directors of.

### Trading on during restructuring

Directors remain in control of the business during the restructuring. It is their responsibility to make decisions regarding the business, pay employees and pay any creditors for debts incurred after the appointment of the RP. These debts must be paid in the ordinary course of business as they are not covered by the restructuring.

Approval must be sought from the RP for any transactions that are outside the ordinary course of business.

### Development of the plan and documentation

The RP is there to assist directors to develop the plan and put together the required information to be sent to creditors within 20 business days.

The documents required are:

- restructuring plan, and



- restructuring proposal statement, which includes a list of creditors and the amount they are owed.

The RP must provide a declaration regarding the plan. However, this is limited and does not require a recommendation to be made to creditors, an analysis of the proposal or a detailed report be provided.

The restructuring plan also provides for the cost of the RP administering the plan. This will be expressed as a percentage of monies paid to creditors under the plan and will be approved by creditors if they accept the plan. The plan can also provide for extra remuneration if the RP needs to attend to court proceedings on the company's behalf.

Given the tight timeframes, there will be a heavy reliance on new provisions allowing for electronic communication and you should expect to receive all correspondence via email.

### 'Voting' by creditors

Creditors have 15 business days from when they are provided with the plan to decide whether to accept it or not.

The plan is accepted if the majority in value of affected creditors who have provided a statement to the RP agree to the plan. Creditors that are related to the company do not get to participate in this process.

Creditors should notify the RP immediately if they disagree with their debt as detailed in the plan, as the RP may refuse to consider a disagreement if it is received outside of the timeframe specified (ordinarily 5 business days after receipt of the plan). Creditors also have the right to appeal to the court regarding the RP's decisions about their debt.

### Application of plan

If creditors choose to accept the plan, it will outline the return expected to be paid to creditors. The payment process under a restructuring plan is much simpler, with no need to formally prove debts as the details of admissible claims are determined as part of the proposal process.

Creditors have the right to make reasonable requests for information during the restructuring and plan stages. More information on [creditor rights in small business restructuring](#)<sup>1</sup> is available on the ARITA website.

### End of plan – completed or terminated

The plan comes to an end when either:

- the terms of the plan are completed, or
- the plan is terminated as the terms of the plan cannot be complied with.

If the plan is completed, the company is released from all debts and is able to continue in operation.

If the plan is terminated, all debts under the plan become due and payable immediately. Directors will then need to make a decision about the future of the company. They may choose to appoint a liquidator or voluntary administrator.

If the directors don't take action to appoint a liquidator or voluntary administrator, creditors are able to take action to have a liquidator appointed.

## Getting the right advice

Understanding what your rights and risks are as a creditor is essential. It's important to only seek advice from a properly qualified expert. While many advisers, including lawyers, may hold themselves out as experts, many are often not fully qualified in the complexities of insolvency law.

ARITA Professional Members, which include accountants, lawyers and advisers, are post-graduate qualified in restructuring, insolvency and turnaround and are required to undertake ongoing education to ensure they are fully up to date with new developments in the law such as this new regime.

Only ever engage with an ARITA Professional Member. You can check on our website to see if your adviser is an [ARITA member](#)<sup>2</sup>.

### Document links

- 1 [https://www.arita.com.au/ARITA/Insolvency\\_help/Insolvency\\_explained/Insolvency\\_and\\_creditors.aspx](https://www.arita.com.au/ARITA/Insolvency_help/Insolvency_explained/Insolvency_and_creditors.aspx)
- 2 <https://www.arita.com.au/member>

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