JOINT INSOLVENCY EXAMINATION BOARD

Joint Insolvency Examination (Scotland)

Wednesday 3 November 2010

PERSONAL INSOLVENCY (3.5 hours)

ANSWER ALL FOUR QUESTIONS

QUESTIONS 1 AND 2 CARRY TWENTY MARKS EACH
QUESTIONS 3 AND 4 CARRY THIRTY MARKS EACH

SUBMIT ALL WORKINGS

The Examiner will take account of the way material is presented. Candidates should answer the questions set – marks will not be awarded for extraneous material.

Note:

References to legislation are to that which was in force on 30 April 2010. References to “the Act” are to the Bankruptcy (Scotland) Act 1985, as amended.

References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.
1. You were appointed trustee over the sequestrated estate of Steve Tosh on 8 September 2010 following the presentation of a sequestration petition to Falkirk sheriff court by H M Revenue & Customs in respect of unpaid VAT. The date of sequestration is 19 August 2010.

The debtor is 55 years old and lives in rented accommodation with his wife and two young children. Steve Tosh operated as a self employed building contractor and signed annual accounts which indicated that he traded profitably for the past 6 years. You are advised that the debtor’s current financial predicament is attributable to a large contract to build a sports stadium in early 2009. Due to unexpected difficulty with the terrain and innovative design of the stands, the contract proved to be a disaster and he lost at least £500,000. Trading activities ceased in early 2010 and all employees were dismissed.

Your assistant provides the following information from initial enquiries:

1. The debtor’s plant, machinery and stock were sold by Scotfree Auctioneers on 13 March 2010. The price achieved was £18,000 plus VAT, costs were £2,000 plus VAT and to date, £11,000 is reflected as received in the cashbook.

2. Book debts recorded in the accounting records total £280,000. Notes on file, which have been prepared by your assistant who was progressing the book debt collection exercise, indicate:
   - one customer paid £15,000 of the £60,000 that is reflected as due.
   - another customer stated that he had paid his debt of £35,000 to one of Steve Tosh’s largest creditors, to whom the debt had been assigned on 16 May 2010.
   - one customer who is due £120,000 has advised that he is owed £40,000 by the debtor for works undertaken and has provided copy invoices.
   - no other responses have been received.

3. The debtor has a personal pension fund with Insurafuture Ltd. Correspondence received in the redirected post shows that the fund was worth £370,000 as at 31 December 2009 compared to £50,000 as at 31 December 2008.

4. Steve Tosh currently works as a contracts manager for a major building company in the central belt. His net monthly salary is £3,500 and his outgoings total £2,200 per month.

5. The debtor and his spouse jointly own four flats in a development which were purchased under the buy-to-let scheme. Properties 1 and 2 are vacant and properties 3 and 4 are tenanted.

   With regard to properties 3 and 4, you have established that the formal lease period has expired and the tenants are in occupation on a month to month basis. Rentals of £1,100 and £800 have been received as they fell due on the first day of each calendar month.

   The monthly mortgage commitment has not been met for 5 months by the debtor and the secured lender for properties 1 and 3 has commenced repossession proceedings. Despite providing notification of the sequestration, there has been no communication from the secured lender for properties 2 and 4.

**Requirement**

Identify the debtor’s potential assets and explain the steps you would take to maximise realisations, noting any issues that might be encountered when dealing with the realisation process and how you might address them.

(20 marks)
2(a) You receive a telephone call from a local solicitor who advises that one of his clients, Stanley Harper, died quite suddenly nearly two months ago at age 49. When conducting an assessment of the client’s financial affairs it was discovered that his estate is insolvent.

**Requirement**

*Set out the steps required to secure your appointment as trustee over the deceased debtor’s estate. (2 marks)*

2(b) You are appointed trustee and the following information is provided to you:

1. **Funeral expenses of £3,500 remain unpaid.**
2. **The debtor had two insurance policies: one for £60,000 which is written in trust for his wife and one which benefits his estate for £15,000.**
3. **The debtor had a pension arrangement with a fund value of £125,000. The beneficiaries are noted as the debtor’s spouse and his two children, aged 21 and 18.**
4. **Mr & Mrs Harper lived in rented accommodation and rent has not been paid since his death. Arrears at date of death are £4,500.**
5. **There are loans and credit card debts totalling £110,000 in the debtor’s sole name.**
6. **The debtor had a mistress with whom he owned a property in Jedburgh. The property is worth £220,000 and there are secured borrowings of £190,000.**
7. **The debtor borrowed £5,000 from his brother to buy a car for his mistress and you are advised that a gold Rolex watch was provided to his brother as security.**
8. **The debtor’s daughter drives a BMW Mini. Although Mr Harper’s daughter is insured to drive, the car is registered in the debtor’s name and subject to finance, in the debtor’s name. You understand that the car is worth £8,000 and the outstanding finance is £9,500.**
9. **Mr & Mrs Harper jointly own a holiday home near Barcelona. It is estimated that the value has decreased from £270,000 to £175,000 with secured borrowings of £245,000.**
10. **The debtor owned a penthouse flat in Leith. The flat is thought to be worth in the region of £120,000 and there is a secured loan of £60,000. The debtor gave the flat to his daughter as a 21st birthday gift 6 months before his death.**
11. **A trust fund was established by Mr Harper for his son’s 18th birthday. £10,000 was paid into the trust fund bank account and it transpires that a loan was obtained to pay for the deposit.**

**Requirement**

*Based upon the information provided, explain how you would deal with each point noted above for the benefit of the sequestrated estate. (18 marks)*

(20 marks)
3. You are approached by a local councillor regarding a social club for members of a large trade union. The club has been operating for almost 70 years and is encountering cash flow difficulties. You are advised that two months ago, the club president resigned, as did the treasurer and secretary.

The club steward, who is acknowledged as the most senior club official, convened a meeting of the members last week. Although only 35 of the club’s 600 members attended, those present agreed that steps should be taken to seek independent financial advice with a view to effecting an orderly closure of the club.

You agree to meet with the councillor and the club steward. At the meeting you are handed a set of financial statements for the year ended 31 May 2009 which reflect a loss of £68,000. You are advised that the steward is not familiar with financial matters but from his last discussions with the former treasurer and president, the trading results for the year ended 31 May 2010 and for the period to date, are expected to be substantially worse. The following information is also provided:

1. The club premises are rented from the local council and the rent (which is nominal) has not been paid for five years. The club steward cannot find a copy of the lease.
2. The club owns all moveable assets in the building. The tables, chairs, etc were bought approximately ten years ago. The kitchen equipment was replaced two years ago in order to comply with health & safety requirements and such equipment is subject to a five year hire purchase agreement.
3. The club is open every day and serves both lunches and evening meals.
4. There are eighteen members of staff: four full time and fourteen part time. Wages are due to be paid at the end of the week.
5. PAYE and NIC have not been paid to HMRC since January 2010 and a charge for payment was served three weeks ago.
6. The club’s bank account is in excess of the agreed overdraft facility.
7. Functions have been booked for the next six Fridays and Saturdays and a local snooker group meet in the club every Wednesday.
8. Several creditors will only supply food and drink if paid for in cash at time of delivery.
9. The brewer has intimated that the remaining kegs will be collected at the end of the month if their outstanding invoices are not paid.
10. Steps have been taken to attempt to generate more income by:
   - hosting local bands, quiz nights, darts nights etc. This has been relatively unsuccessful.
   - minimal increases in the prices of food and drink. This was met with fierce opposition from members, many of whom are pensioners on restricted income.
   - increasing the annual subscription by £5. Initially, the members refused to pay because the constitution did not allow for annual increases without approval at an AGM.
11. The annual membership fee is £60: 25% of members pay the annual subscription by monthly direct debit; 30% pay by cheque/cash on a monthly basis, and the remaining members pay in advance within 3 months of the commencement of each financial year on 1 June.
(12) The former treasurer operates his own book-keeping business and maintains the club’s accounting records. The former treasurer allegedly removed an oil painting purportedly worth £2,000 because of his unpaid fees.

(13) The club is not attracting younger members and current members do not frequent the club often enough to allow the club to operate profitably

Requirements

(a) Prepare a letter to the club steward and outline the options available. (12 marks)

(b) Set out the steps you would take to ensure that you can act for the club if appointed as trustee. (3 marks)

The club is sequestrated and you have taken office.

(c) List the potential assets that are available and set out the steps that you would you take in order that you can realise them, noting any particular difficulties that you anticipate. (7 marks)

(d) List the key issues that require to be addressed in the first few days and set out how you would deal with each one. (8 marks)

(30 marks)
4. Crawford Mackay is 54 years old and trades as Wheezo, a manufacturer of bespoke bagpipes. He operates the business from Hambleton House, a substantial property originally purchased by his father and inherited jointly by him and his brother in 1987. Wheezo employs five people and makes annual profits before drawings and tax in the region of £70,000.

Your enquiries show that the debtor withdrew too much from the business and the cash flow situation was worsened when a bad debt of £40,000 was incurred in March 2008. Upon recommendation by his bank, Crawford Mackay contacted you for independent financial advice and subsequently signed a trust deed on 5 November 2008. The proposals presented to creditors which resulted in the trust deed becoming protected were as follows:

- a monthly contribution from earnings of £3,000 from 1 November 2008.
- the equity in the debtor’s matrimonial home in Portree is to be realised within eighteen months of the trust deed becoming protected.
- if there are insufficient funds to settle creditors’ principal claims in full no later than 5 November 2011, the debtor’s share of the equity in Hambleton House will be realised.
- the trust deed is to last either four years, or earlier if all creditors’ principal claims are paid in full.
- the debtor’s stock and equipment will be retained by the debtor on the condition that all creditors’ principal claims are settled in full during the four year period.
- dividends are to be paid on an annual basis.
- the trustee’s fees are estimated at £6,000: £2,500 for the first year, £1,000 for years two and three and £1,500 for the final year.
- £2,000 is to be retained in the trustee’s bank account at all times until the trust deed is concluded lest it be necessary to petition for the debtor’s sequestration.

During a recent quality control review the file note prepared reveals the following:

1. The matrimonial home was valued at £380,000 and the interest-only mortgage is £360,000. The property is registered in the joint names of the debtor and his spouse.
2. Hambleton House was valued at £500,000 in October 2008 on an open market basis and assuming existing use. It is subject to a mortgage of £420,000. When the trust deed was signed, the debtor’s accountant advised you that there would be a capital gains tax liability of around £60,000 if the property was sold.
3. Part of Hambleton House is let for £12,000 per annum to Tipple & Co, a firm of wine merchants.
4. The business and assets of Wheezo were valued at £80,000 on a going concern basis and £15,000 if the business were to cease.
(5) Creditors comprise:

<table>
<thead>
<tr>
<th>Creditor</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>HMRC: VAT</td>
<td>£60,000</td>
</tr>
<tr>
<td>HMRC: PAYE/NIC</td>
<td>£15,000</td>
</tr>
<tr>
<td>HMRC: income tax</td>
<td>£66,000</td>
</tr>
<tr>
<td>Loan from the debtor’s uncle</td>
<td>£120,000</td>
</tr>
<tr>
<td>Trade creditors</td>
<td>£25,000</td>
</tr>
<tr>
<td>Employees: payment in lieu of notice and redundancy</td>
<td>£30,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£316,000</strong></td>
</tr>
</tbody>
</table>

(6) Under the terms of the trust deed, the debtor’s uncle’s claim is deferred until all other creditors have been paid in full.

(7) Employees’ claims did not crystallise because they were retained to work in the business which Crawford Mackay continued afresh when the trust deed was signed.

(8) The most recent monthly contribution from the debtor was in July 2010.

(9) HMRC have written to advise that the VAT return for the quarter to 30 September 2010 has not been received.

(10) During a telephone conversation with the debtor’s spouse, she said that she and her husband have separated and she will not co-operate with any remortgage process.

**Requirements**

(a) Prepare a receipts and payments account of the trust deed as at today’s date stating any reasonable assumptions you consider necessary. (15 marks)

(b) Write of a memorandum to describe the issues that should be considered and the steps that require to be taken to progress the trust deed. The memorandum should include financial illustrations where applicable. (15 marks)

(30 marks)