

Limited liability is now the preserve of the free-loade...

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It is the day of the year when, at least with regard to political economy, almost nothing seems to have happened. I am aware of others news, but that is for others to comment on. I will stick to political economy, and that's on its summer holiday.

In that case let me do what politicians will not, and discuss an idea that could result in action.

The idea is limited liability, in the form of the limited liability company.

The suggestion is that this idea is being widely abused.

The action required is to prevent that abuse.

Let's be clear what limited liability is. It is the protection provided by law to the shareholders or members of a company that means that so long as they have paid all that they owe for their share then they have no further liability for the debts of the company that they own if it is unable to meet its obligations to pay.

To be clear, a company does not have limited liability: it has full responsibility for its debt. It is its members who enjoy limited liability.

But the consequence is that the company does have limited liability because if it cannot pay it can be liquidated without recourse to its members, and usually its directors (unless they can be shown to have traded recklessly or whilst knowingly insolvent), and the creditors of the company will suffer the loss that the company has incurred. The result is that a moral hazard is created, with the cost of trading or other losses being transferred to those who did not create them.

The risk of this happening (because its possibility was always understood to exist) was meant to be mitigated in several ways:

* By reason of the company being required to have sufficient share capital to ensure that a buffer existed to prevent losses being passed on to creditors.

- * By requiring the provision of up to date accounting information on the company to Companies House for it to place that data on public record so that those supplying credit to the company might know the risk that they were taking.
- * The requirement that details of all shareholders and directors of the company be placed on public record so that the identity of those with whom the creditor is really trading is known, as companies do not have their own personalities.
- * Rules on protecting creditors were put in place, meaning that this was supposedly the primary task of the directors of the company and that they must not trade if those creditors were at risk of loss.

These days all of these protections have been abandoned.

The vast majority of companies have share capital of less than £10. Larger companies are mainly reliant on debt for their funding and not capital. The essential idea that capital should be at risk in limited liability companies has disappeared.

Well over 90 per cent of all companies now qualify to file micro or small company accounts - which deliver effectively meaningless data to those who search this information on public record. Attempts to change this are moving pitifully slowly.

And when it comes to large companies, it is quite explicitly stated by accounting standards setters that the data supplied is only for the purposes of credit appraisal and that no data for any other purpose is within the scope of those standards - meaning that these companies can very often deliberately omit vital data on key issues of concern.

Meanwhile, shareholder and director details have disappeared from or been obscured on public record, the former most especially since 2016.

And, the idea of protection of creditors has become meaningless when hundreds of thousands of companies are struck from the Register of Companies each year without any investigation or attempt being made to secure protection for any creditor of any sort.

In other words, every protection for society from abuse by those owning limited companies has been removed whilst simultaneously the scale of those companies in terms of size, number and impact on society has grown out of all proportion to that which any Victorian who first enacted legislation to permit their widespread use could have imagined.

Worse, the right to limited liability without disclosing details of the ownership of an entity now appears to be considered a human right in some countries, including within the EU - which is utterly absurd. This is ownership without obligation being passed into law.

So what can and should be done about this? A number of obvious suggestions follow:

- 1) Companies must have a capital commensurate to their level of trading and those not doing so should be able to call on their shareholders to make good the deficiency in the event of an insolvency. Shareholding cannot be seen to be a risk free activity when it clearly is not.
- 2) All company accounts should be available on public record, in full, and accounting standards should ensure that they are designed to meet all shareholder needs.
- 3) Companies failing to file accounts on time should lose the benefit of limited liability until they do so.
- 4) Details of all directors and shareholders should be on public record. Those companies not filing correct data should lose their limited liability.
- 5) All companies must be required to file tax returns annually (most do not at present). Those that do not should have personal liability imposed on the directors for tax owing.
- 6) No company should be struck from the Register of Companies without filing accounts, including creditor lists, if insolvent. Anyone missed from the list should have a personal claim against the directors of the company.
- 7) Banks must be required to share with Companies House and HMRC annually the details that they should on the company, its trading addresses, the shareholders and directors and must supply a figurine for sums deposited in all bank accounts that they holds for it. In the absence of company supplied data this information should be placed on company record in place of company supplied data.

These measures will be seen as tough, and there will be howls of protest from 'free marketeers'. But why? Limited liability, as Adam Smith knew and did not like, creates the chance for free riding, moral hazard and straightforward abuse that undermines all theories of market competition. So, such protest cannot actually be about free markets. It would, more like, be a defence of free-loading, because that is what limited liability has become, and what it will remain as unless action to end abuse is taken.