FIDUCIARY DUTIES AND TAX AVOIDANCE

OPINION

Introduction and summary of conclusions

1. We are asked to advise whether a person may be said to be under a "fiduciary duty" to avoid tax. We address this question by reference to the duties of company directors as imposed by statute (which are sometimes loosely referred to as "fiduciary duties"), and also by reference to fiduciary duties in the strict technical sense of the term. Our opinion is given in respect of the law of England and Wales as at the date hereof. It is provided to our client Tax Justice Network Ltd for circulation at their discretion but it may not be relied on by any other person, except in circumstances expressly approved by us in writing.

2. "Tax avoidance" may be variously defined depending on context and ideological bent but we adopt a deliberately wide definition in order to ensure that this opinion applies to tax avoidance by any definition. Our conclusions are applicable to any specific deliberate course of action that, because of tax, yields a more financially advantageous result than another available course of action which is nonetheless reasonable in the circumstances. Our conclusions are therefore equally applicable across the spectrum from unexceptionable tax planning to criminal tax evasion, although of course it goes without saying that there can be no legal duty to engage in the latter.

3. In summary, we conclude as follows:

   - It is not possible to construe a director's statutory duty to promote the success of the company as constituting a positive duty to avoid tax.

   - On the contrary, the legislation expressly protects directors from criticism in circumstances where they take decisions based on the kind of factors which would militate against tax avoidance (e.g. change-of-law risk, reputation, brand impact, relationship with HMRC and community impact).

   - Any internal policy framework for responsible UK corporate taxpayer conduct should ideally therefore be drafted with reference to that statutory protection.

- A director's duty to exercise reasonable care, skill and diligence is not a duty to avoid tax, particularly in view of the role generally played by external advisers.

- The idea of a strictly "fiduciary" duty to avoid tax is wholly misconceived.

It is not possible to construe a director's statutory obligation to promote the success of the company as a positive duty to avoid tax

The nature of the statutory duty to promote the success of the company

4. It is sometimes said that company directors have a duty to maximise profits and it is on the basis of this purported duty that they are said to be required to avoid tax. Strictly speaking corporation tax is charged on profits and so such a duty, if it existed and were to be construed as a duty to avoid all taxes including corporation tax, would have to be expressed by reference to after-tax profits or distributable profits or some such. In fact, however, such a duty is unknown to English law in any event.

5. Similarly it is sometimes said that company directors have a duty to act for the benefit of shareholders, and since tax avoidance on the part of the company may be expected to benefit shareholders financially, this purported duty is said to translate into a duty to avoid tax. Again, such a duty is unknown to English law.

6. The duty which most closely corresponds to these purported duties is the duty to act in a way which the director considers would be most likely to promote the success of the company. This duty is enshrined in s.172(1) Companies Act 2006. We quote it here in full:

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to--
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct,
>
> and
>
> (f) the need to act fairly as between members of the company.

7. The language regarding "for the benefit of the members as a whole" is not there to impose a duty on directors to act for the benefit of shareholders; it serves to establish that it is by reference to the benefit of the entire body of shareholders taken together (effectively the same body of persons as the company itself) that the success of the company should be sought, as opposed to, for example, one particular shareholder or sub-group of shareholders.

8. Further, the duty is not to achieve objective success for the company so that measurable shortfall or even failure on the part of the company constitutes breach; the duty is merely to act in a way that the director "considers" would be "most likely to" promote the success of the company. In other words it is a subjective test and it is concerned with the success of the company as an aim on the part of the director rather than as a result for the company. The practical reality, therefore, is that any business decision taken in good faith in pursuit of the success of the company upon proper deliberation and with regard to the relevant factors is going to be found by the courts to be within the scope of a director's duties under s.172, and the courts will not generally entertain under this head an enquiry as to whether the decision was objectively a good one, or even a reasonable one, unless the defects in the decision amount to evidence running counter to the director's account of it (*Re Smith and Fawcett Ltd* [1942] Ch 304; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; see also *Palmer's Company Law* at paragraphs 8.2608 and 8.2609).

Matters to which directors should have regard when discharging that duty

9. In circumstances where a director decides that the company will eschew tax avoidance, he or she may do so for reasons that he or she considers to be aligned with the long-term success of the company, including for example (i) the adverse risk profile of tax-structured transactions in the long term, (ii) the desirability of investment in public health, education, infrastructure &c in the jurisdictions where the company's employees live and work, (iii) the need to foster the company's relationship with tax authorities and with consumers, (iv) the impact of tax avoidance on the wider community of taxpayers and users of public services, and (v) the desirability of the company maintaining a reputation for high standards of business conduct. A company director is expressly mandated to have regard to these factors when acting in pursuit of the success of the company by (respectively) sub-subsections (1)(a), (1)(b), (1)(c), (1)(d) and (1)(e) of s.172 and it follows that if he or she had in good faith and upon proper deliberation eschewed tax avoidance for reasons like that, he or she would be immune from judicial criticism under that section.

10. Further, given that s.172 Companies Act 2006 manifestly does not constitute a duty to maintain exclusive focus on the company's short-term financial

bottom line, a court should treat any proper business reason for eschewing tax avoidance which does not fall within sub-subsections (a) to (f) as falling within the "other matters" which subsection (1) does not list but which the director may have regard to as the basis for his or her decision, notwithstanding an adverse short-term impact on distributable profits when contrasted with a course of action involving tax avoidance.

11. Our view that other kinds of impact may constitute a legitimate basis for a director's decision notwithstanding an adverse financial impact may be derived from the clear meaning of the section alone, as explained above, but it is also supported by the pre-existing case law on the corresponding common law duty (to which the courts are still required to have regard by virtue of s.170(4) Companies Act 2006). For example in *Re Welfab Engineers Ltd* (1990) BCLC 833 the directors were found by Mr Justice Hoffmann (as he then was) not to be in breach of their duties when they deliberately sold a real property asset at an undervalue, in circumstances where they did so in order to protect the jobs of the company's employees.

Conclusions regarding s.172 Companies Act 2006 and tax avoidance

12. In view of the general nature of the duty in s.172 Companies Act 2006, and specifically in view of the matters to which directors are mandated to have regard when discharging that duty, we are of the opinion that it is not possible to construe that duty as constituting a positive duty to avoid tax.

13. We would add that there are several other mechanisms that impact on board-level decisions aside from legal duties personally enforceable against directors. In the case of, for example, codified corporate governance practice and performance-related executive reward structures, these mechanisms may tend towards the result that the board is motivated to act to the measurable financial benefit of shareholders. A person unfamiliar with the law in this area might assume without further enquiry that these mechanisms emanate from underlying legal obligations likewise tending towards that result. An erroneous assumption along these lines, rather than a misunderstanding specifically of s.172 Companies Act 2006, may account for the widespread perception that directors are under a legal obligation to act in pursuit of shareholders' measurable financial benefit, and consequently to avoid tax.

A director's duty to exercise reasonable care, skill and diligence is not a duty to avoid tax

14. A director's duty under s.174 Companies Act 2006 to exercise reasonable care, skill and diligence does not relate to specific outcomes but to the existence or absence of negligence in the process of arriving at those outcomes. Clearly a decision which is taken on the company's behalf with due care, skill and diligence cannot be a breach of duty under this head, even

where the outcome is tax payable which would not have been payable otherwise.

15. In practice company directors tend to engage specialist external advisers to assist them with tax matters and larger companies will also have a specialist internal tax function. Since tax planning decisions almost invariably have wider commercial ramifications of one kind or another (for example because they involve choosing between different business structures, or between different jurisdictions, or between different risk profiles), tax specialists are accustomed to presenting the options to management and treating the choice between those options as a commercial matter for management rather than a technical question for themselves.

16. In these circumstances the position of management is in direct contrast to the position of a professional tax adviser who is potentially liable in negligence for such avoidable tax as may arise. Management will be involved precisely because the question is a matter of commercial judgment falling outside the scope of the duty of care of a person retained specifically to advise on tax.

17. Naturally that commercial judgment must be exercised in good faith in proper discharge of the board's duties under s.172 Companies Act 2006. Likewise, in order for the board to discharge its duties under s.174 in such a situation, due care, skill and diligence must be exercised in such peripheral matters as selecting and instructing the tax advisers and arriving at an understanding of the options on offer. As with the duty under s.172, however, the duty under s.174 does not generally militate in favour of any specific tax outcome.

The proposition that there might be a strictly "fiduciary" duty to avoid tax is wholly misconceived

18. Fiduciary duties are duties imposed by equity on persons bearing a fiduciary relationship to other persons. By way of example of this kind of relationship, agents owe fiduciary duties to principals, solicitors owe fiduciary duties to their clients and (before such duties were replaced by statutory duties in Companies Act 2006) directors formerly owed fiduciary duties to companies.

19. Not all duties imposed on persons in a fiduciary role are specifically fiduciary duties. For example, the use of the term "fiduciary duty" to refer more loosely to a fiduciary's obligations to act with care and skill in pursuit of his or her principal's best interests was roundly deprecated by Lord Justice Millett (as he then was) in *Bristol & West Building Society v Mothew* [1998] Ch 1. In a similar vein, only the statutory directors' duties in respect of conflicts and bribes (i.e. sections 175-7 Companies Act 2006) are described in *Palmer's Company Law* as "true fiduciary duties" (paragraph 8.2902).

20. A fiduciary duty in the strict technical sense is a duty imposed on fiduciaries to pursue the interests of their principals specifically in preference to their own interests. It is therefore of the essence of a scenario in which a fiduciary duty arises that there exists in that scenario a conflict of interests between the fiduciary and the principal or, at the very least, an opportunity for the fiduciary to profit personally from his position as fiduciary. If there is no such conflict or opportunity then any duties owed in the scenario will not in the strict technical sense of the term be fiduciary in nature.

21. It is of course possible to imagine a scenario in which a decision not to avoid tax could personally benefit a fiduciary, so that fiduciary duties would be engaged in the context of that decision. For example a fiduciary might be offered a personal inducement by a tax authority to procure that his or her principal does not enter into a tax avoidance scheme. But in this scenario the fiduciary would be prohibited from accepting the inducement rather than being required to avoid the tax, it being the acceptance of the bribe that is the breach of fiduciary duty, rather than the course of action that the bribe is intended to induce. Indeed there is a strict rule of long standing against any enquiry into whether the course of action induced by a bribe did in fact run counter to the interests of the principal, "for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an inquiry as that" (*per* Sir W.M. James LJ, *Parker v McKenna* (1874) LR 10 Ch App 96 at 125).

22. A comparable analysis may be expected to apply in any other scenario in which a decision not to avoid tax could personally benefit a fiduciary. It is more-or-less impossible to imagine a realistic scenario in which, in order to discharge his or her fiduciary duty, a fiduciary is required to take positive steps to avoid tax. In our opinion, therefore, the proposition that there might be a strictly "fiduciary" duty to avoid tax (or a like duty to be inferred from the equity-derived duties in sections 175-7 Companies Act 2006) is wholly misconceived.

Drafting a protective policy document regarding responsible corporate taxpayer conduct

23. Even in the absence of a positive duty to avoid tax, a board choosing not to avoid tax may feel better protected from criticism if it does so by reference to a formal policy document regarding its approach to responsible corporate taxpayer conduct. It would be prudent to draft any such document in such a way as to ground the company's internal tax policies in the factors to which directors are required to have regard when promoting the success of the company, and in particular in the factors in subsections (1)(a) to (e) of s.172 Companies Act 2006.

24. For example, a multinational group might develop a policy that required the group's officers to ensure that the profits of the group are (so far as possible) equitably allocated around the group, favouring to the extent possible a corporate tax footprint in the jurisdictions where the group's employees live and work in substantial numbers and/or the jurisdictions where the substantive profit-making activity takes place. Such a policy would be most useful to the board of a UK parent seeking to demonstrate proper discharge of its duties under s.172 Companies Act 2006 if it were documented as having been adopted by reference to, for example, (i) the long-term interest of the company in forestalling adverse changes to the global system of company taxation, (ii) the interests of the company's employees, (iii) the need to foster the company's relationships with tax authorities and with consumers, (iv) the impact of the company's operations on the community, and (v) the desirability of the company maintaining a reputation for high standards of business conduct.

25. As noted above, however, there are other mechanisms that impact on board-level decisions aside from legal duties personally enforceable against directors, and such a policy may not be consistent with the operation of those mechanisms.

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