NOT JUST ANOTHER ARTICLE ABOUT BTI V SEQUANA

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For a judgment so eagerly awaited, its arrival was a little anti-climactic

For that reason, this is not another article about the decision of the Supreme Court in BTI 2014 LLC v Sequana SA [2022] 3 W.L.R. 709; at least it is not only about that. The majority (although not ad idem as to its precise formulation) affirmed the decision of the Court of Appeal that a director's duty to act in the company's interests was modified so as to include a duty to act in the interests of creditors as a whole when the director knows or ought to have known that: (i) insolvency was "imminent" (i.e. "just round the corner and going to happen") or; (ii) it was "probable" that the company would enter into an insolvent liquidation or administration.

This article looks at the future application of the "creditor duty" (actually a duty owed to the company about its creditors) in the context of cases where questions of imminence and probability are more nuanced than the rather stark facts of Sequana allowed, and particularly with reference to liabilities to HMRC which have arisen by reason of a company's participation in tax avoidance schemes.

Tax schemes typically involve payments from the company to the directors and/or shareholders, via some intermediate step (for instance, a trust or a conditional share scheme), which is intended to relieve the obligation of the company to set aside and account for PAYE and NIC. Those schemes are typically open to attack in one of two ways, either:
(a) as a means of effecting disguised distributions in breach of Part 23 of the Companies Act 2006 which unlawful per se (as in Toone v Ross (Re Implement Consulting Ltd) [2020] 2 B.C.L.C. 537); or (b) on the basis that the directors acted in breach of their duties to act in a manner that they considered in good faith as likely to be in the best interests of the company (including, under section 172(3), the "creditor duty") (as in Hunt v Balfour-Lynn (Re Marylebone Warwick Balfour Management Ltd) [2022] EWHC 784 (Ch)).

The unlawful distribution analysis is not without logical difficulties. First, the principal (perhaps, only) creditor in the liquidation will be HMRC, whose proof of debt will be for PAYE and NIC. That does not sit easily with the argument that the payments were distributions to shareholders. Secondly, the disguised distribution analysis ignores the interposition of independent trusts and trustees.

That leaves the liquidator of a company which has participated in tax avoidance schemes with claims for breach of duty under section 172. A director is entitled to arrange a company's affairs to minimise its tax liability, providing that this does not cross the line into dishonest tax evasion. Either a scheme is successful in avoiding the tax charge prescribed by legislation or it is not, but entry into the tax avoidance scheme is unlikely itself to be a breach of duty. The question is whether the "creditor duty" makes what is otherwise permissible decision-making by directors, in seeking to limit the company's tax bill, a breach of duty?

It may take many years for the efficacy (or otherwise) of a particular scheme to be finally determined. However, that decision, when it is made, expresses

the law as it has always been (In re Spectrum Plus Ltd (in liquidation) [2005] 2 A.C. 680). That means that a company might participate in a scheme for many years, without its directors knowing that it is contrary to the law as it will eventually declared to be.

It is in those cases that the decision of the majority in Sequana is likely to be important, since it has preserved the requirement that, for the "creditor duty" to arise, the director must have actual or constructive knowledge of the company's imminent or probable insolvency.

In a case where the director has taken professional advice and has placed reasonable reliance upon it as to the probable efficacy of the tax scheme, this conclusion means that he or she is unlikely to be found to have breached the "creditor duty", both by taking the advice in the first place and by reaching the reasonable subjective view in reliance upon that advice that a liability to HMRC would be unlikely to eventuate.

Had an objective test been adopted (a solution preferred by Lord Reed, without expressing a final view on the point) that might mean, for instance in the case of companies that have used EBTs over many years before the Supreme Court's decision in RFC 2012 plc [2017] 1 W.L.R. 2767, that the company was insolvent almost from the start. That would leave the director liable for potential breach of the creditor duty in circumstances where he or she, acting in good faith, would not have concluded that the company was likely to end up with a significant liability to HMRC.

The contrary argument is that, on those same facts, the director is not obliged to enter into the tax avoidance scheme at all. The choice to do so is no doubt motivated by the personal incentive of the receipt of money through the scheme. He or she has chosen to take a risk in circumstances where the advice received from the professionals will never guarantee the participant in the scheme of success. However, such an argument would require the court to sit in judgment on commercial decision-making (an exercise the courts generally abjure). It requires the directors to hold the company harmless for liabilities which were incurred in good faith and for the benefit of the company's shareholders, no matter how negligible the risk of liability to HMRC was reasonably understood to be.

These questions are still to be worked through and (as Lady Arden observed at [416]) have not received particularly detailed consideration in the first instance decisions to date. The appeal in Marylebone Warwick (due to be heard in March next year) provides an early opportunity to do so.