

What is a shadow director?

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SHADOW DIRECTORS

[24.4]

The impact of the benefits code is much wider than might be assumed. The reason is that the rules apply not only to company directors and employees but also to individuals who, although not formally appointed as a director, have significant influence over the management of the company, sufficient to render them shadow directors. This is because the term 'director' in the benefits code includes any person in accordance with whose directions or instructions the actual directors are accustomed to act (ITEPA 2003, s 67(1)), although an exception is made for those advising in a professional capacity (s 67(2)). The scope of the term 'shadow director' is considered below.

For a long time, it was commonly considered that the definition in s 67 did not bring any shadow director who was not an actual employee into the benefits code. The basis for this view was that the code applies to employees and office-holders and, while s 67 treats shadow directors as directors, it does not also deem them to be employees or office-holders. It is widely accepted, including by HMRC, that a shadow director does not hold an office (see NMWM05150).

An argument along these lines was, however, rejected by the House of Lords in *R v Allen* [2001] UKHL 45, [2001] STC 1537, [2001] 4 All ER 768, on the grounds that it was the intention of Parliament in enacting what is now s 67 that accommodation and other benefits in kind received by a shadow director should be taxed in the same way as those received by an actual director. A strong case can be made that this decision was technically flawed. However, it was a decision of the House of Lords, and therefore, the chances of it being revisited seem slim.

Accordingly, the position now is that if a person falls within the definition of shadow director in s 67 and he receives a benefit, which would be within the ambit of the benefits code if he were an actual director, he is caught by the code. This is so regardless of whether he could be characterised as an employee.

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Before answering the question of what a shadow director is, it is worth touching on the related, but distinct, concept of de facto directorship. A de facto director is an individual who purports to act as a director, although he has not been validly appointed as such (*Re Paycheck Services 3 Ltd* [2009] EWCA Civ 625, [2010] Bus LR 259, [2009] STC 1639 at para 55; upheld in *Revenue and Customs Comrs v Holland* [2010] UKSC 51, [2011] 1 All ER 430, [2011] STC 269).

A shadow director, by contrast, does not purport to act as director. The term 'shadow director' does not, strictly, apply to someone who participates in board meetings as if he were a director, but rather to someone behind the scenes who, broadly, directs or controls the action taken by the company. It has been stated that shadow directorship connotes the situation where there are de jure directors 'but in fact behind them strings are being pulled by some other persons who do not put themselves forward as appointed directors' (*Re PTZFM Ltd* [1995] 2 BCLC 354). It is most common for such string-pulling to occur on the basis that the shadow director is a sole or majority

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shareholder in the company, or a beneficiary of a trust which is such a shareholder. In practice, shadow directorship is much more commonly encountered than de facto directorship.

Ensuring that a person is not a shadow director is rendered difficult by the Court of Appeal decision in *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340, [2000] 2 All ER 365, CA. This was not a tax case but turned on the company law definition of 'shadow director' in the Company Directors Disqualification Act 1986, s 22(5). This defines a shadow director as:

"a person in accordance with whose directions or instructions the directors of the company are accustomed to act."

This definition is essentially in the same terms as the final limb of ITEPA 2003, s 67, cited above; and like s 67 it excludes professional advisers.

In *Deverell*, the trial judge had asserted two important limitations to the definition, as follows:

"... Advice on its own will not do. Only if such advice is so given and so accepted as to amount to a direction or instruction (coupled with a pattern of the board being accustomed to act on it) is it relevant."

"Directions or instructions are both words with a mandatory effect. Coupled with the word "accustomed" they ... contemplate a situation where the board has cast itself in a subservient role to the "shadow", i.e. it does what it is told or to borrow an expression from trust law it "surrenders its discretion" to the shadow. Being accustomed to follow what somebody says does not of itself make what is said a direction/instruction ... What the court has to find, whether on direct evidence or inference is that the board does what [the shadow] tells it and exercises no (or at least no substantial) independent judgement."

These limitations were based on *obiter dicta* in earlier cases and were widely regarded as correct by advisers. However, they were rejected by the Court of Appeal, which in substance accepted the Secretary of State's formulation as follows:

"It is suggested that the definition is concerned to identify those with real influence in the corporate affairs of the company whatever the label given to the communications from the shadow to the board. Thus, it is argued, all that is required is that what is said by the shadow to the board is not by way of professional advice but is usually followed over a wide enough area and for long enough. In other words frequent non-professional advice usually acted on is sufficient."

The Court of Appeal emphasised that the shadow director's influence did not have to be over the whole field of the company's activities. Instead, it adopted the words of an Australian judge (Finn J) in *Australia Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1:

"The reference in the section to a person in accordance with whose directions or instructions the directors are "accustomed to act" does not in my opinion require that there be directions or instructions embracing all matters involving the board. Rather it only requires that, as and when the directors are directed or instructed, they are accustomed to act as the section requires."

In *Deverell*, the Court of Appeal concluded that the two individuals under attack were shadow directors. The facts were complex and are not altogether easy to follow in the reported case. However, the following words effectively summarise the factual basis for the decision:

"[The judge's findings] make it plain that Mr Deverell was concerned at the most senior level and with most aspects of the direction of the company's affairs. This could only be achieved by an ostensible consultant if those who were directors acted upon his directions or instructions conveyed by words or conduct. The judge held in terms that Mr Deverell "bossed everyone around from the directors downwards". It is immaterial that, as the judge observed, he was the sort of man who would boss anyone around. The facts, as found, show that he bossed the directors around and, because what he achieved was within the province of the directors, the directors were accustomed to submit to his requirements."