

The Deverell case: a shadow of doubt



The concept of the shadow director is relevant in the context of company law and taxation. Shadow directorship can bring financial liabilities and disqualification for the shadow director upon the insolvency of a company, or cause such an individual to be a “person with significant control” (PSC). In the latter case, this will probably be the last thing such an individual will want if he has appointed directors to manage and control his business to maintain confidentiality.

In the tax field, a UK-resident shadow director of an offshore company may suffer UK taxation under the “benefits in kind” legislation e.g. rent free occupation of a UK residential property owned by an offshore company.

Shadow directorship therefore has serious implications for a private client thinking of using a professional corporate service provider to act as a director of a company in which he or she may well own share capital.

Shadow directorship also has potentially adverse consequences for those professionals nominated by the private client to act as director (i.e. as *de jure* director). A regulator will be unlikely to view favourably situations where one of its regulated corporate service providers has allowed a private client to become a shadow director – especially if, as a result of the actions of the shadow, significant economic damage has been done to third parties.

A shadow director is in reality a director, albeit not formally appointed according to the company’s articles or the Companies Acts. The shadow must be a person in accordance with whose directions or instructions the *de jure* directors are accustomed to act. Directors and their nominators need to keep this definition in mind at all times. However, since the Deverell case (of which more below) it is arguably more difficult for those that “lurk in the background” to avoid becoming shadow directors.

Case law prior to the Deverell case required the *de jure* directors to “surrender their discretion” to the shadow. Consider the following pre-Deverell judicial dicta:

In [Lo-Line Electric Motors Ltd \[1988\]](#) it was stated by Browne-Wilkinson V-C that a shadow director presupposed a board of directors “...who act in accordance with instructions from someone else, the eminence grise or shadow director.”

In [Unisoft Group Ltd \(No. 3\) \[1994\]](#), Harman J said “...the shadow director must be in effect the puppet master controlling the actions of the board. The directors must be the cat’s paw of the shadow director. They must be people who act on the instructions or directions of the shadow director as a matter of regular practice.”

In [Re Hydrodam \(Corby\) Ltd \[1994\]](#) Millet J (as he then was) said “to establish that a defendant is a shadow director of a company it is necessary

to allege and prove that the defendant directed those directors how to act in relation to the company, that those directors acted in accordance with such directions; and that they were accustomed so to act. What is needed is first, a board of directors claiming and purporting to act as such, and secondly, a pattern of behaviour in which the board did not exercise any discretion or judgement of its own, but acted in accordance with the directions of others.”

In [Australian Securities Commission v AS Nominees Ltd](#) (considering legislation cast in the same terms as the UK legislative definition of a shadow director) Finn J said “...the idea of the section...is that the third party calls the tune and the directors dance in their capacity as directors. The question the section poses is, where, for some or all purposes, is the focus of effective decision-making? If it resides in a third party...and if that person cannot secure the “advisor” protection, then it is open to find that person a director for the purposes of the Corporations Law.”

At first instance in [Secretary of State for Trade and Industry v Deverell \[2001\]](#) the trial judge said that the existence of a shadow director contemplated a situation “...where the board has cast itself in a subservient role to the “shadow”; i.e. it does what it is told... what the court has to find...is that the board does what the shadow tells it and exercises no or at least no substantial independent judgement.”

However, the Secretary of State appealed the first instance decision of Judge Cooke to the Court of Appeal. The leading judgement of Morritt LJ has arguably made it more likely that a third party, such as a beneficial owner of a company, who communicates advice or guidance to the de jure directors is a shadow director. In his judgement (which was not appealed), Morritt LJ made the following conclusions on the concept of the shadow director:

1. The purpose of the legislation is to identify those, other than professional advisers, with “real influence in the corporate affairs of the company”.

2. Whether any communication from an alleged shadow director to the company is a “direction or instruction” must be objectively ascertained in the light of all the evidence. But is it not necessary to enquire into the understanding of the giver (e.g. the shadow’s expectation that he will be obeyed) or the receiver (e.g. the director’s abnegation of his power and duties of management and control).

Indeed, the judge stated that “in many if not most cases it will suffice to prove the communication and its consequence”.

Moreover, the judge was clear on the point that non-professional advice came within the statutory description of “directions and instructions”. He also opined that it was not necessary to show that the directors had surrendered their discretion (although such surrender would inevitably lead to the conclusion that a person communicating advice to the directors proper is a shadow director).

Before Deverell, tax advisers were generally of the view that the danger of being a shadow director for the purposes of the benefits in kind legislation was reasonably remote provided that the directors did not surrender their judgement and gave independent consideration to what they were being asked to do or approve, and provided the alleged shadow avoided giving instructions or directions. Now it is possible that even if directors give independent consideration to what they are doing, a non-professional “adviser” may be a shadow director (and therefore, also a PSC, whose particulars must be entered on the PSC register).

[Implication of Deverell](#)

For tax purposes and PSC disclosure purposes, it may no longer be enough for directors to show they have given independent consideration to requests from a third party (often a beneficial owner of a company’s shares). Regular approval of proposals put to the board may render the “proposer” a shadow director, and therefore, a PSC or (in the case of an offshore company) a recipient of benefits that may be taxed under income tax legislation.

However, another view is that the Deverell decision may have gone too far, with insufficient consideration in the judgement paid to the standards of de jure directorship.

[Addressing Deverell](#)

In the context of the PSC legislation (where statutory guidance says that shadow directors are PSCs under para 5 of Schedule 1A CA 2006) and income tax legislation, an anti-dote to the dangers of shadow directorship may be to create trusts. If the would-be shadow director is a settlor, then the trustees must observe their duties to benefit beneficiaries (of which the settlor may be one) and the trustees are also entitled to consider the wishes of the settlor.

Therefore if the trustees, in their independent judgement, deem it appropriate to accede to a settlor’s request or advice, they can communicate their decision to the directors of the UK Company. In this case, it is reasonable to argue that if anyone is a shadow director, it is the trustees.

Professional trustees and directors are arguably a robust bulwark against the insidious tide of legislation encroaching on the individual’s human right to privacy and confidentiality. Provided that professional trustees or directors satisfy themselves that their clients’ needs for confidentiality are lawful, then protection from disclosure as a PSC (e.g. protection from shadow directorship) is often possible. Inevitably, the individual seeking confidentiality must accept a significant degree of loss of control, but provided he chooses his professional corporate and trust service providers carefully, the risks of loss of control are more apparent than real.



Martin Palmer
Director & Principal
Jordans Trust Company
Limited

T +44 (0)117 918 1321
E mpalmer@jordustrustcompany.com

WHAT TO LOOK FOR IN A UK CORPORATE SERVICE PROVIDER:

A note for lawyers, accountants, company directors and company secretaries



UK companies are now subject to increasing legal and regulatory burdens which for most businesses represents a significant challenge. Late filing of annual confirmation statements or financial statements now generate significant financial penalties, and directors of UK companies now face the threat of criminal prosecution for various administrative derelictions including late filing of accounts. This criminalisation process has only been increased by the new UK company “PSC” register.

The PSC register is, in effect, a beneficial owner register that must be available for public inspection. Failure to create a PSC register, or keep it up to date, is a criminal offence, and the criminals will include the officers of the UK company. Given the political investment made by the UK government in the PSC register, UK companies are well-advised to adhere to the detailed requirements of the regime.

Jordans Trust Company can provide appropriate company secretarial, legal and accounting support to UK companies, large or small to protect UK companies and its officers from fines and criminal prosecution. Our services include:

- Undertaking the maintenance and updating of a UK company’s statutory registers (including the PSC register).
- Dealing with all statutory filings and disclosure requirements, including the annual confirmation statement.
- Providing strategic and detailed ad hoc advice on the PSC register regime.
- Preparing paperwork for companies on an ad hoc basis to deal with changes of share capital, or name, or the articles.
- Legal drafting for corporate procedures including class rights and bonus issues.

- Statutory accounts preparation.
- VAT registration and administration.
- Directorships (our ability to accept company directorships will depend on the circumstances of each case).
- Finance Director services (e.g. preparation of management accounts and cash-flow forecasts, PAYE, sales and purchase ledger management etc.).

The breadth of Jordans services makes us an ideal “one-stop shop” choice of corporate service provider for taking over the administration of a UK company whose current service providers are in some way falling short of the company’s needs or expectations. This may be to do with service levels, technical competence, or inability to provide for the company’s service requirements under one roof – which is an important advantage UK client companies obtain by using Jordans.

MEET THE TEAM

In any business transaction it helps to put a face to a name, and a clear advantage of working with Jordans is that you get direct access to director level and head of department staff who make up the core of our corporate service provision. Please don't hesitate to contact them.



Martin Palmer

Director & Principal

T +44 (0)117 918 1321

E mpalmer@jordanstrustcompany.com



Evia Soussi

Head of Corporate Governance

T +44 (0)117 918 1427

E esoussi@jordanstrustcompany.com



Jason Reader

Associate Director

T +44 (0)117 918 1387

E jreader@jordanstrustcompany.com



Nicola Morgan - Schulz

Accounting Services Manager

T +44 (0)117 918 1241

E nmorgan-schulz@jordanstrustcompany.com