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FURTHER GUIDANCE ON TAX AVOIDANCE SCHEMES AND CREDITOR DUTY

Earlier this month the High Court handed down judgment in *Hunt v Singh [2023] EWHC 1784 (Ch),* on appeal from the decision in *Hunt v Balfour-Lynn & Ors [2022] EWHC 784 (Ch)* which we covered in our May 2022 Bulletin.

Following the landmark ruling of the Supreme Court in *Sequana* in October 2022, *Hunt v Singh* gives further guidance on when directors of financially distressed companies should consider their duties to creditors. It also addresses whether that duty should be taken into account when a company is insolvent due to liabilities incurred by a tax avoidance scheme which directors, having taken advice, believe would not be payable.

In 2022, importantly prior to the Supreme Court's ruling in *Sequana*, the Insolvency and Companies Court gave judgment in *Hunt v Balfour-Lynn* and found that in that instance the directors were entitled to rely on professional advice provided to them by BDO Stoy Hayward regarding an EBT tax avoidance scheme. That was despite HMRC challenging the scheme from 2005.

In *Sequana* the Supreme Court confirmed that in certain circumstances when a company is financially distressed, the directors' fiduciary duty to the company is modified to include a duty to have greater regard to the interests of creditors.

BDO had informed the directors that the scheme was "robust" and continued to give such assurances despite repeated warnings and challenges from HMRC. In *Sequana* the Court of Appeal had determined that the duty to consider creditors' interests arose *"when the directors know or ought to know that the company is or is likely to become insolvent…In this context likely means probable"*.

The ICC Judge in *Hunt v Balfour-Lynn* considered the credibility of BDO's advice and concluded that their continuing advice meant that the duty to creditors was not met. In *Hunt v Singh* there was essentially one question in the Appeal. Was the ICC Judge wrong to conclude that the creditor duty threshold had not arisen?

Readers may recall that in *Sequana* the question of insolvency was based on whether, had future contingent liabilities (in that instance prospective fines for pollution) crystallised, that would render a company insolvent. The Supreme Court held that the company was not insolvent and therefore the threshold for creditor duty had not arisen.

However, the Supreme Court left unresolved whether directors had to have knowledge of insolvency for the creditor duty to arise. In *Hunt v Singh* the High Court considered it was necessary to establish some form of knowledge of insolvency (whether actual or constructive) for creditor duty to arise.

From 2005 onwards the company was clearly insolvent and the likelihood increased as HMRC confirmed it would pursue litigation and the tax liability increased. The ICC Judge had therefore applied the wrong test in deciding that the directors had acted reasonably by taking advice and acting upon it in respect of the HMRC claims. There was a *"world of difference"* between trading on and making further losses in contrast with proposing to declare dividends of all available assets and leaving nothing to pay a disputed liability (which was the situation in *Hunt v Singh).*

There is also the possibility of a defence under section 1157 of the Companies Act 2006 as to whether Mr Singh had acted honestly and reasonably and ought fairly to be excused. The matter was referred back to the ICC Judge for further consideration.

Editor's Note

Mr Singh is now bankrupt. It remains to be seen whether this matter will be pursued, but regardless, this judgment indicates that directors must continue to seriously consider whether a tax avoidance scheme will render them in breach of their duties.

Office-holders will welcome that as directors can no longer argue that they relied on professional advice as an iron-clad defence.

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