Development Securities: what directors of Jersey companies should continue to do

Service area / Corporate
Location / Jersey
Date / January 2020

Don't worry, this isn't another briefing that anxiously sets out new standards of corporate governance required as a consequence of the recent *Development Securities* judgments. On the contrary, our view is that those English judgments tell us little about corporate governance of Jersey companies that was not already known, and in fact support our long-held view that what some may see as corporate governance 'best practice' should instead be considered as the 'only practice'.

Key points

The key points that come out of the *Development Securities* judgments in a corporate governance context are as follows:

- A court may examine pre-incorporation planning in determining whether a company's board was operating on an ongoing basis or to undertake another's plan: future board members should be sufficiently involved.
- The court may review board minutes and handwritten notes of board minutes: avoid conflicting records and prepare long form draft minutes in advance.
- The court may be critical of material matters discussed in board meetings not being recorded in board minutes, and of directors not being sent relevant emails or spending sufficient time considering matters: again, prepare long form draft minutes in advance and, where meetings must be held at short notice, company advisers can attend the meeting to brief directors.
- It could be argued before the court that directors with numerous directorships were not abreast of and focused on relevant transactions.
- Shareholder resolutions authorising directors' actions may be the subject of lengthy arguments and comprehensive analysis: they can be authorisations but not instructions.
- Provided a Jersey company's directors exercise proper judgment, its central management and control does not vest in its sole parent even where it carries out the purpose for which it was set up in accordance with the intentions, desires and even instructions of the parent.
- Directors of a Jersey company that is a wholly-owned special purpose vehicle and which is to enter into a transaction that does not prejudice its creditors act in the best interests of the company where they act in the best interests of the company's sole shareholder.

Further details follow.

What are the *Development Securities* judgments?

The *Development Securities* judgments are three judgments of the UK Tax Tribunal, a first instance judgment and two appeals, which looked at whether three Jersey companies (the "Jcos") were tax resident in the UK at the time they entered into certain transactions. It is the two appeal judgments that are of most interest in a corporate governance context, being:

- Development Securities v HMRC *[2017] UKFTT 0565 (TC)* (the "First Appeal"), rejecting the taxpayer's appeal to the First Tier Tribunal against a decision of HMRC in respect of various CGT capital loss relief provisions; and
- Development Securities v HMRC *[2019] UKUT 169 (TCC)* (the "Second Appeal"), a further appeal, to the Upper Tribunal, which overturned that earlier decision but did not undermine the importance of the corporate governance points raised in the First Appeal, some of which are as set out in the table below.

Summary of background facts

A summary of background facts is as follows:

- The three Jcos were incorporated as part of a scheme to crystallise latent capital losses in UK real estate. Each had a board consisting of two Jersey professional directors and one client UK director. Board meetings were held in Jersey. The Jcos were intended to be Jersey tax resident at the relevant time (and on the Second Appeal this was found to be the case).
- Under the scheme, the Jcos acquired assets at an undervalue under call option agreements while Jersey tax resident and then became UK tax resident before disposing of the assets. This would mean that for UK tax purposes the Jcos would suffer a loss as between the acquisition price (base cost plus indexation) and the sale price (market value).
- The directors were not comfortable that entry into the transactions forming part of the scheme was in the best interests of the Jcos. As a consequence, the shareholders of each Jco passed resolutions (together the "Shareholder Resolutions") confirming that entry into the call option agreements was in the best interests of the relevant Jco and authorising the directors to enter into, execute and deliver those agreements, under a specific provision of the Companies (Jersey) Law 1991 ("CJL"). That provision provides for a 'whitewash' process by which no act or omission of a director is treated as a breach of statutory duty, including the duty to act "*...with a view to the best interests of the company*", if all the members of the company authorise or ratify the act or omission and after the act or omission the company will be cash-flow solvent.
- One of the professional directors estimated that he was a director of at least 40 to 50 client companies of various types and would attend about 25 to 30 board meetings each month.

Actions of directors

Whilst UK tax was the focus of those judgments, some corporate governance-related aspects of the First Appeal are set out in the following table, with a summary of how we continue to advise clients on those issues:

Corporate-governance aspect	Summary of what we continue to advise
The Tribunal looked at how the relevant transaction was planned before the Jcos were incorporated, as part of assessing whether the board was appointed to operate each company on an ongoing basis or to undertake a specific defined action planned by others.	Care should be taken with pre-incorporation planning that does not involve all of the intended Jersey board. Preferably all intended directors should be involved, although in practice they may not want or need to be copied in to all emails, involved in all calls etc. The key thing is to ensure that the intended directors are involved early enough and at a sufficient level to enable them to properly make decisions when required, rather than those decisions being a *fait accompli*.
The Tribunal reviewed both board minutes and handwritten notes of board meetings.	Handwritten notes of a board meeting may not accurately reflect what happened in that meeting and may not, for example, correctly set out important legal issues that were discussed, either because they were not understood by the person taking the notes or because that person used terminology that suggested a different legal action was taken or process was followed from that set out in the formal minutes. Where possible, draft long-form minutes should be prepared before a board meeting, setting out for example all the intended agenda in proper detail and the correct treatment of legal requirements, and amended as necessary after the meeting to ensure that what happened in the meeting is accurately recorded. The directors of a Jersey company should always consider the reasons for entry into a transaction, including the risks and benefits of such entry and such consideration should be recorded in the relevant board minutes. If handwritten notes are taken, they should be dealt with in accordance with a document retention policy; they should not be destroyed *ad hoc* simply because they do not support the version of events set out in the formal minutes, but at the same time they need not be kept forever, particularly where directors or other people who attended a meeting have been given the opportunity to comment on minutes before they are finalised. The same applies to recordings or transcripts of meetings.
The Tribunal was critical that certain material matters that may have been dealt with in board meetings were not recorded in the minutes.	As above, the use of draft long-form minutes, which include terms of proposed discussions on key aspects of particular transactions/documents and can be amended after the meeting, reduces the risk of omission of material matters and discussions.

Continued

Corporate-governance aspect	Summary of what we continue to advise
The Tribunal was critical of some directors not being sent relevant emails and seemingly not spending sufficient time considering matters.	Directors must be supplied with all information that impacts on the board's decision-making on a proposed transaction. The board must have sufficient time to consider such proposed transactions (including that information) before the relevant board meeting. Where a meeting needs to be held quickly and the directors may not have sufficient time to wade through a large volume of information in advance, it can be helpful if the company's advisers participate in board meetings to provide summaries of documents and information to directors which expressly flag key matters that are or may be relevant to the directors' decisions.
Whilst the court drew no inference from it, HMRC suggested that as the Jersey directors held a large number of other directorships they were "*not up to speed and focused*" on the relevant transactions in the scheme.	As above, it is important that all directors (including professional directors) have opportunity to, and do, properly consider each transaction to which each Jersey company of which they are directors is to be party. Usually it is not enough for such consideration to be given only in the relevant board meeting, although as noted above this is something that can often be managed in cases where meetings need to be held quickly.

Actions of shareholders

Whilst the Second Appeal overturned the First Appeal, this did not undermine the importance of the corporate governance points raised in the First Appeal, some of which are set out in the table above. But in overturning the First Appeal's conclusion on the place of the Jcos' central management and control (in the context of deciding where those companies were tax resident), the Second Appeal stated that the Tribunal in the First Appeal had misunderstood the nature of the Shareholder Resolutions. Specifically, the Upper Tribunal concluded that those resolutions were passed for the purposes of authorising a course of conduct which might be in breach of directors' duties and were not, as the Tribunal in the First Appeal had held, instructions from the parent companies.

Whilst principally relating to English tax matters, the lengthy arguments and comprehensive analysis of the Shareholder Resolutions do not cause us to change the following advice we give in relation to shareholder authorisations/ratifications:

- Where the corporate benefit accruing to a company as a result of its participation in a transaction is unclear or difficult to quantify, or is at best minimal, the board may wish to seek to rely on the 'whitewash' process in the CJL in connection with any potential breach of directors' duties. As a general rule, this is the only circumstance in which that process should be used.
- Exceptions to that general rule do arise; there may be another, commercial, reason to obtain shareholder authorisation/ratification. For example, in English financing transactions, shareholder resolutions may be required by the lender's counsel when a Jersey company is to provide upstream or cross stream security/guarantees. Any such requirement should be considered carefully and discussed by the directors and such consideration and discussion should be recorded in the relevant board minutes.

The position of a company doing what it was incorporated to do; 100% subsidiaries

In considering the place of the Jcos' central management and control, the Upper Tribunal in the Second Appeal stated that the fact that a wholly owned subsidiary "*carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent does not mean that central management and control vests in the parent*" and that it was enough that the directors exercised proper judgement.

The Upper Tribunal also stated that where a Jersey company has no employees and a transaction does not prejudice creditors, the primary regard of the directors ought to be directed to what is in the best interests of the sole shareholder as shareholder. In other words, in such cases the best interests of the sole shareholder are the best interests of the company.

Conclusion

The corporate governance-related aspects of the First and Second Appeals that we have summarised above were not surprising and have not affected the advice that we continue to give, including as summarised above.

By consistently following such advice and ensuring that what some may call 'best practice' becomes the 'only practice', directors of Jersey companies whose transactions are challenged in court may well avoid lengthy and detailed scrutiny of the kind that the directors of the Jcos were subjected to in *Development Securities*.

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Key contact

For further information or professional advice please contact:

James Willmott
Partner

D +44 (0)1534 822307
E james.willmott@careyolsen.com

FIND US

Carey Olsen Jersey LLP
47 Esplanade
St Helier
Jersey JE1 0BD
Channel Islands

T +44 (0)1534 888900
E jerseyco@careyolsen.com

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Visit our corporate team at careyolsen.com

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