Tax Justice Network
ISRAEL

The Fiduciary Duties and the Duty of Care of Directors, Corporate Organs and Professional Consultants with regard to Tax Planning

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March 2015

The Corporate Social Responsibility Institute

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The borderline between legitimate tax planning while conducting business activity and the abuse of tax instruments in order to reduce tax liability (commonly known as "aggressive tax planning") is a vague one. The current tax literature and tax rulings usually focus on the ways to define that borderline. The basic assumption of the current discourse is that the burden to prove whether tax planning is not legitimate lays on the tax authorities. Under this assumption, every tax planning included in a self-reported tax assessment is considered legitimate as long as the tax authorities did not disqualify the self-reported tax assessment and the position of the tax authorities was upheld by the courts.

The current paper challenges this basic assumption by examining the complicated nexus of liabilities and duties of different high functionaries who work in the corporation (such as the CEO, the directors, the external directors, as well as lawyers and accountants) with regard to different cases of tax planning.

The liabilities of each type of functionaries in the corporation have a built-in tension. On the one hand, they are all obligated to act in the best interest of the corporation and have a fiduciary duty to maximize the corporation's profits. On the other hand, they are all subject to their general obligation to act in accordance with the criminal law, corporate law and public law as far as it governs business activity. Furthermore, they are subject to additional sets of obligation – a general fiduciary duty to the public and to the creditors (in the case of external directors) as well as ethical standards of conduct required from lawyers and accountants.

The paper analyses the proper balance between the obligations of different functionaries to the corporation, their obligations to the public and the professional ethical code.

In this regard, while the paper is based on the Israeli law, the fiduciary duties of functionaries to the public, derived from public law and ethical codes – are shared also by other legal systems, and while modifications are required, the analysis offered in the paper might be helpful to tax justice activists from other legal systems.

The paper concludes as follow:

- **In the process of planning the corporation's business activity, all the relevant functionaries, including the CEO and the directors are obliged to take into account tax considerations in order to reduce the tax burden on the corporation.**
  However, this obligation does not apply to professional consultants, such as lawyers and accountants, which are not organs of the corporation and have no fiduciary duty to maximize the corporation' profits. Their obligation is to ensure that the corporation's activity is legal and that its reports- submitted to the authorities- are accurate.
  Nonetheless, the corporation's functionaries are allowed to consult with lawyers and accountants as to the preferable tax structuring of a business venture.
- On the other hand, in cases where the tax planning raise the possibility of illegal tax planning ("tax avoidance") and might lead to criminal liability, none of the corporation's functionaries or professional consultants is obliged to take part in the tax planning. Furthermore, **all functionaries and professional consultants are obliged to refrain from any involvement in the illegal tax planning.** Any involvement in such tax planning, including by negligence or by turning a blind eye, which creates criminal liability to the corporation

may lead to a personal criminal liability of the functionary or the professional consultant.

In this regard, only in certain circumstances a functionary will be able to avoid criminal liability by arguing she relied on a professional advice and therefore was not aware of her criminal actions.

In addition, if the functionaries who assisted to such tax planning are lawyers and accountants, they may be also accused in violating their ethical liabilities and face ethical sanctions as well.

- **Aggressive tax planning**, which does not create criminal liabilities, triggers a more complicated balance between the fiduciary duties of the functionaries to the corporation, and their obligation to uphold the public's interest. In this regard, an aggressive tax planning will be perceived as any tax planning that a reasonable functionary should have anticipated that the tax authorities will not approve.

  We will argue that due to the obligation of the corporation itself to refrain from any activity which does not alien with the public interest, **no obligation to engage in aggressive tax planning exists.** This is further supported by the general obligation (determined in the commercial field) of functionaries to act in good faith. In other words, neither the corporation itself nor any functionary in the corporation will have any personal civil liability as a result of not engaging in aggressive tax planning.

  Furthermore, **in some cases, the fiduciary duties of functionaries to the corporation will oblige them to avoid aggressive tax planning, and the failure to fulfil this obligation may expose the functionaries to personal civil liability.** Two main scenarios may trigger such personal liability.

  A first case where the functionaries did not take into account the possibility that the tax authorities will not approve the tax planning and as a result- will restructure the business activity. In such case the functionaries might be found negligent for unexpected results of higher corporate tax burden and consequences of restructuring business activity.

In addition, if the corporation is publicly traded, and the reported tax rate is based on the assumption that the tax planning will not be challenged by the tax authorities although there is a significant possibility that the tax authorities will review and restructure, such reporting might be a misleading prospectus, thus triggering both civil liability of the corporation and the functionaries.

As to the external directors, the paper shows that they have an obligation, in cases of aggressive tax planning, to prevent the abuse of such tax planning in order to reduce the corporation's assets, thus increasing the risk allocated to the creditors. For example, if the corporation immediately distributes all its profits as dividends, and afterwards the tax authorities restructures the transaction, the risk of insolvency will be fully allocated to the creditors. Thus, the external directors should object to such tax planning.

In regard to professional consultants, such as lawyers and accountants, it will be argued they are not obliged to engage by consulting or supporting functionaries in aggressive tax planning. Furthermore, participation in aggressive tax planning might be seen as a violation of their ethical duties (as they are subject to enhanced loyalty obligation to the public, for example as 'officers of the court').

- As previously noted, distinguishing legitimate tax planning from aggressive tax planning is not easy. The quick changes of the business world, as well as the frequent modifications of the Israeli tax laws and accounting standards, create situations with no legal precedence, and even if the transaction is truly motivated by business considerations and is not aimed for tax reduction, a corporation may face uncertainty in regard to its tax liabilities. Yet, the uncertainty in those cases does not release the functionaries and the professional consultants from their obligation to examine the legal status of the tax planning, both from a criminal and civil perspective.

Furthermore, in such case, a significant weight will be given to the question whether the corporation applied the tax authorities with a request for a pre-ruling. In this regard, the professional consultants, which have enhanced loyalty to the public, must explain to the relevant functionaries their legal exposure, and the possibility of pre-ruling request. In cases in which the reasonable professional consultant would refrain from taking part in the aggressive tax planning, and the corporation refuses to address the tax authorities and ask for a pre-ruling, the professional consultant is obliged to resign.

Though in the Israeli case law, as mentioned, a significant weight is given to the avoidance from pre-ruling in such borderline cases, we argue that from a normative perspective the weight given to such avoidance should be subject to the specific circumstances of the case, including the size of the transaction, the urgency of the transaction and so forth.