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Sir Adrian

Directors and Officers Insurance

I have recently become aware that there is a thoroughly unsatisfactory situation regarding potential tax liabilities on individual Directors in connection with D & O insurance policies.

As I understand it, there are four areas of uncertainty:-

(i) If the premium for this insurance is wholly paid by the Company, does any part of it constitute a taxable benefit-in-kind for individual directors?

(ii) If a Director or whole Board of Directors is sued for negligence or some other breach of duty and the sums awarded are effectively paid by the D & O insurance policy, could the Director or Directors face a claim by the Inland Revenue for tax on the insurance payment?

(iii) If a company obtains dispensation from its Tax Inspector that the payment of the whole of the D & O premium does not give rise to any P11D liability for any of the individuals covered, does this automatically mean that there is no question of the proceeds of any insurance claim being liable to tax?

(iv) The payment of an appropriate part of the D & O premium by individual Directors and Officers appears to avoid any P11D liability. Does it also remove the risk of being taxed on the proceeds?

This subject was raised with me recently by Derek Cook, a newly appointed non-executive Director of Kwik Save, who sits on a number of other Boards. I have raised it with all six Boards with which I am involved. The position that emerges is as follows.

The Inland Revenue has not issued any general practice note on the subject, and individual tax offices are giving inconsistent decisions on the P11D Question. (Of my companies, one has received a clearance that there is no P11D liability and believes this removes the risk of any tax liability on any insurance claims proceeds. Another was specifically refused clearance and is charging Directors £100 contribution to the premium. A third received a P11D clearance and is receiving confusing advice from Peats on whether this avoids a possible tax liability on a policy payment. A fourth applied for P11D clearance over 12 months ago and has had no reply from the Tax Inspector!)

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...Uncertainty as to whether there could be P11D liability on a part of the insurance premium is an irritant but not a serious worry. The possibility that the Inland Revenue might seek to tax the proceeds of an insurance claim in the hands of a recipient is an extremely serious worry.

Obviously, in a well managed company with a proper Board with experienced non-executive Directors, the possibility of a successful claim against any of the individual directors is, or should be, remote. However, we live in an extremely litigious world and however responsibly a Board and its individual members behave I do not think the possibility of successful litigation can ever be totally excluded, particularly in regard to acquisitions and disposals.

Those companies that are most in need of experienced non-executives with good reputations are precisely those where past Board behaviour has not always been impeccable and where even the best non-executive Directors may have some difficulty in ensuring the highest standards of procedure. It will become virtually impossible to find suitable non-executive Directors for such companies if it appears that going on the Board would risk not only some damage to their reputation but also to their assets.

I am informed that the ABI has made representation to the Inland Revenue and to the Financial Secretary to the Treasury to try and obtain a ruling that no taxable liability on individuals could arise in connection with D & O insurance but "this lobbying has proved unsuccessful and the ABI has concluded that as the current incumbent Financial Secretary is unsympathetic to the problems created the issue should be left [illegible] for the moment".

This is a totally unsatisfactory situation and if it becomes generally known, it will be even harder than it is now to find an adequate number of good non-executives – particularly for those companies who most need them. (It will not do a lot for the peace of mind and confidence of executives either!)

Your position as the "guru" of Corporate Governance has brought you into contact with most of the relevant members of the financial establishment, particularly the Bank of England, which I imagine could well be both sympathetic and [illegible?influential?] Would you be willing to try some lobbying?

[Handwritten] with best wishes,

Yours sincerely,

[signed]Tim