



Law Society
of Scotland

Consultation response

Corporate transparency and register reform:
implementing the ban on corporate directors

February 2021



Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

Our Banking, Company and Insolvency Law Sub-committee welcomes the opportunity to respond to BEIS and Companies House's consultation on *Corporate transparency and register reform: implementing the ban on corporate directors*.¹ We have the following comments to put forward for consideration.

Response to questions

The Principles

1. In your view, will the proposed 'principles' based exception deliver a pragmatic balance between improving corporate transparency and providing companies adequate scope to realise the legitimate benefits of the use of corporate directors?

These principles deliver a pragmatic balance.

The Scope

2. Bearing in mind the transparency objective, is the scope of the exception proportionate and reasonable?

The scope will provide additional compliance burdens to overseas companies, who will have to satisfy the requirements of their own jurisdictions, and also additional ID requirements at Companies House. Work will be needed to ensure that the technical requirements for non-UK residents and companies to verify their identities is achievable by them (eg in the unlikely event that country X does not require the issue of photo ID for passports or drivers' licences, that should not preclude an individual from country X becoming a director, nor company Y acting as a director if its directors are individuals from country X).

¹ <https://www.gov.uk/government/consultations/corporate-transparency-and-register-reform-implementing-the-ban-on-corporate-directors>

Similarly, requirements for overseas companies to verify that they only have natural directors should be proportionate and not prohibitive.

3. Q. Assuming that ID verification will form a fundamental element of the corporate director regime, what do you see as the arguments for and against allowing LPs and LLPs be appointed as corporate directors? If they are to be allowed, how should the principle of natural person directors apply within these partnership models?

It should be noted that English LPs cannot become directors as they do not have separate legal personality. As such, the issue arises only for LLPs and Scottish LPs. For Scottish LPs, any activities will be undertaken by their general partner. It makes sense for a Scottish LP to be able to be a director if its GP(s) are natural persons or only have natural persons as directors. For LLPs, the position is more difficult as the relevant stake is a combination of ownership and management. As such, requiring all directors of a corporate director to be individuals has less of an effect on ownership structure (and profit distribution) than it does for LLPs. Perhaps the way to cut through this is to allow an LLP to be a director of a company so long as its members are either (1) natural persons, or (2) non-natural persons (including LLPs, companies and Scottish LPs) whose directors/members are natural persons.

Compliance and Reporting

4. Do these reporting requirements appear proportionate and reasonable?

No, we consider that the “up-the-chain” effect is excessive. Consider a situation whereby company D (to follow the example in paragraph 25) conducts a range of activities, of which one small part is to have a corporate directorship in a small company. This prevents company D from changing their own corporate structure. This is incongruous with company law – whilst directors may owe duties to the company, with the company being able to sue for breach of such duty, it does not go so far as to legally prevent the director from breaching that duty.

The same end can be achieved in a more proportionate way by stating that if company D has (or appoints) a corporate director, then company D’s directorship of company A automatically terminates. Given that companies also need to have at least one natural director anyway, there should not be a case whereby the operation of this provision causes any issues.

Impacts

5. Q. Does the Impact Assessment provide a reasonable assessment of the costs and benefits of the prohibition and possible exceptions? In particular:

• Do you have any evidence as to why companies have reduced their use of corporate directors since the primary legislation was passed?

We think that uncertainty as to the ongoing validity of appointments of corporate directors has driven their decline.

• Do you have any evidence on what might be the costs to companies from the proposed restrictions on corporate directors?

We do not have a quantification of this.

Potential for Extending Corporate Director Principles

6. Q. What are your views on applying the proposed Corporate Director principles more broadly to a) LLPs, and b) LPs, and how would you envisage ID verification operating in those contexts?

These principles should not be applied to LLPs or LPs as the partnership stake contains both ownership and management interest. As such, applying it to LLPs or LPs has the same effect as requiring company directors and shareholders to adhere to this regime, which is a dramatic extension to current proposals.

Furthermore, we note that in practice both forms of partnership are used extensively in multi-level group structures – which would be destroyed by requiring individuals at “one level up”. For example, it would not be possible applying the regime proposed for companies for a Scottish limited partnership to be used as a “feeder fund” to receive investment funds from institutional investors which the feeder fund would then pass on as a partner in other partnerships set up to invest in different types of assets. This structure is very common and partnerships are normally used because they are both tax transparent and permit flexible organisation and management of investments. On this scenario only individuals and not institutional investors could invest in the feeder fund and fund managers would probably use investment vehicles established in Luxembourg or other non-UK jurisdictions instead of UK partnerships when setting up these types of funds.

It is, in addition, common (again normally for reasons of tax transparency) for general partners in limited partnerships established for investment purposes themselves to be Scottish limited partnerships. The “general partner” limited partnership will be fully liable for all of the liabilities of the investment partnership of which it is general partner as a matter of normal partnership law and the general partner of the “general partner” limited partnership will in turn be liable for those liabilities under that law. If the general partner of the “general partner” partnership requires to be an individual under a new regime, that individual will then be personally liable for all of the liabilities of the investment partnership. As individual liability will not be commercially acceptable in these circumstances, it is again likely that a tax-transparent non-UK entity will be used as the general partner of the investment partnership instead of a UK entity.

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