

Discretionary trust summary

- 1 Please note that although we have not been asked to provide specific tax, estate planning or asset protection advice, we have provided some general information in relation to the potential issues to be aware of. You must ensure that you obtain specialist advice if you would like to deal with any of the potential issues that may arise.
- 2 Although this area of law has remained constant over many years, it is important to regularly consider any potential changes to the law in the future.
- 3 The below information is not intended to be an exhaustive list of trust law but rather a detailed summary of the key trust law issues you should understand and be aware of.
- 4 If you would like more specific advice in relation to proposed transactions in relation to your trust, please ensure you obtain specialist advice prior to undertaking such transactions.

Trusts overview

- 5 A trust is a legal relationship where there is:
 - a a legal owner of property (the '**Trustee**'), who;
 - b holds the property ('trust property');
 - c for the benefit of others (the '**Beneficiaries**'); and
 - d pursuant to certain terms or rules ('trust deed', which is the document provided to you to initially sign to create the trust).
- 6 Unlike companies and sole traders, a trust is not generally a separate legal entity. Instead, the Trustee looks after the property and manages the trust. Any benefits generated from the trustee's management can then be given to the Beneficiaries.
- 7 The effect of this is that the Trustee effectively carries the risk of looking after and managing the property, but the property and the benefits derived are not the Trustee's automatically. They are for the Beneficiaries.
- 8 There are various types of trusts, however, the one established for you is called a 'discretionary trust'.
- 9 This means that there is a broad **discretion** to decide who can benefit from the trust.
- 10 Other types of trusts may fix who can benefit or have a mixture of fixed entitlements and broad discretions. Specialist advice should be obtained prior to utilising these structures as there are different trust law and tax issues to consider.
- 11 Please also be aware that other trusts may be created by the law. That is, other trusts may be created without the need for having a trust deed. These trusts are classified as 'resulting' or 'constructive' trusts in that the law imposes such a relationship to ensure equality where needed.
- 12 These classes of trusts are not relevant in what you have established but may arise where there is an understanding that a person is holding property for the benefit of others. They have been mentioned in this letter to make you aware of the various forms trusts can take.

Trustee

- 13 As mentioned above, the legal owner of the property is the Trustee.

- 14 A Trustee can be one or more individuals and/or companies. There can generally be no more than four Trustees appointed at any one time.
- 15 If there are more than one entities acting as Trustee, it is important to review the trust deed to confirm how those Trustees should act. Absent of anything contrary, Trustees would be prudent to act jointly.
- 16 Please note that where the Trustee is a company, the directors of the company will have the day-to-day control of the trust.
- 17 As the Trustee is the legal owner of the property, they can effectively make any decision they choose in relation to the property.
- 18 As a result, there is potential that the Trustees may act in a manner inconsistent with the best interest of those who they are managing the property for (i.e. the beneficiaries).
- 19 To reduce the potential for this conflict, the Trustee is subject to various duties. Where the Trustee is a company, the directors will be required to ensure decisions by the company do not breach these duties.
- 20 A summary of these duties are as follows:
- a to act in the best financial interest of the beneficiaries and not profit from their role;
 - b to act impartially as between beneficiaries;
 - c not to act at the dictation of another person;
 - d to familiarise themselves with the terms of the Trust and to comply with the terms of the trust deed and trust law;
 - e to avoid conflicts of interest;
 - f to keep proper accounting records; and
 - g to exercise their duties at least to the standard of that of an ordinary prudent business person.
- 21 A Trustee cannot profit from their role; they may however receive remuneration pursuant to the terms of the trust deed (or by order of the Court). Trustees can be reimbursed for expenses properly incurred and the trust deed should be reviewed to confirm this, if such remuneration is intended.
- 22 A breach of the above duties can potentially mean the Trustee is personally liable without any of indemnity from the trust property.
- 23 Generally, the liability of a Trustee for breach of trust includes an account of profits and compensation. Compensation will be awarded to restore the trust estate to the same position it would have been in, had the breach not been committed.
- 24 If you would like more detailed advice in relation to any of the Trustee duties, please let us know.
- 25 Given the Trustee's role in being the legal owner of the property, it is also important to appreciate that the Trustee will be also liable for any risks arising from the management of the property.
- 26 This means that the Trustee may be sued in their capacity of holding the trust property. Such liable can potentially affect assets held by the trustee personally.

- 27 As such, Trustees holding substantial assets in their personal name should reconsider their appointment as trustee for the trust.
- 28 There are, however, generally provisions in the trust deed, that allows the Trustee to be indemnified from such liability, however, this relies on the trustee having abided by their duties mentioned above as well as the trust deed containing such provisions.

Beneficiaries

- 29 As outlined above, the Trustee manages the trust property for the benefit of others, being the Beneficiaries.
- 30 Further, the discretionary trust structure enables income that is earned by the trust to be distributed to the Beneficiaries of the Trust, in such proportions as the Trustee decides.
- 31 If the Trustee wants to distribute to a person or entity, the Trustee must ensure such a person/entity is included within the definition of 'Beneficiary' in the trust deed.
- 32 That means, the trust deed must be reviewed to confirm if the intended recipient of assets or income from the trust, is included in the class of persons/entities who are defined to be a Beneficiary.
- 33 Normally, the trust deed specifically names one or more persons to be a Beneficiary of the trust.
- 34 The definition of Beneficiary is then expanded to include additional persons, including, for example, a mother and father, children and grandchildren, any brothers or sisters of any of the specifically mentioned persons, any other trust in which any of these people are potential beneficiaries, and any company in which any of these people hold an interest.
- 35 These people are often referred to as '*discretionary beneficiaries*'. The idea of including a large number of discretionary beneficiaries is to provide the Trustee with maximum flexibility when distributing income.
- 36 It is noted that none of the discretionary beneficiaries have any entitlements to anything in the trust unless the Trustee decides otherwise. Further, none of these Beneficiaries can force the Trustee to make a distribution to them.
- 37 There may also be a clause enabling certain persons to nominate additional persons to be a beneficiary if they did not fall within the class. The trust deed, however, should be reviewed to ensure this broadness.
- 38 Again, the Trustee has the ability to decide the proportions in which the income of the trust is distributed among these potential beneficiaries, based on what will be appropriate, given the needs of the beneficiaries and what is most tax effective in any given year.
- 39 One common strategy is to include a company as a potential Beneficiary of the Trust. Companies are currently taxed at a flat rate of no more than 30%, therefore the distribution of income from the trust to the company, can be an effective strategy to limit the overall tax paid by a family group.
- 40 Specialist tax advice, however, should be obtained from your tax advisor prior to making such a distribution.
- 41 If the Trustee fails to nominate who would benefit from the trust assets or income, there are usually provisions outlining a default position.

- 42 That is, certain persons may benefit from the asset or income if the trustee fails to make a decision. These people are generally known as the '*default beneficiaries*'.
- 43 Every trust deed can be different on this default position but it is common for the default beneficiaries to either be the specifically named persons, or for such income to be accumulated by the trust.
- 44 In contrast with the discretionary beneficiaries, the default beneficiaries will only have a right if the Trustee fails to make a decision. Again, the default beneficiaries cannot force the Trustee to make a distribution to them in any other circumstance.

Controller role

- 45 Although the Trustee has the day to day management over the trust assets, some trusts includes a specific role with the power to change the Trustee.
- 46 This role often called the 'appointor' or 'principal' role. It may also occasionally be called a 'guardian'.
- 47 The trust created for you has called this role 'Appointor'.
- 48 The ultimate control of your trust, therefore, lies with the Appointor, as the person in this role has the ability to decide who acts as Trustee for the trust.
- 49 In addition to having the power to change the Trustee, depending on the terms of the trust deed, the Appointor may have additional powers. Therefore, the inclusion of such a role means that the trust deed should be carefully reviewed to identify the rights and powers for such a role.
- 50 Additional powers could include the need for the Trustee to obtain the consent from the appointor/principal prior to specific decisions being made.

Settlor

- 51 The Settlor is the person who settles the trust. This is by way of the Settlor giving an initial sum (usually \$10) to the Trustee to hold pursuant to the terms of the trust deed.
- 52 In Australia, that is the extent of the settlor's role, and they are often specifically excluded from obtaining any form of benefit under the trust deed.
- 53 It is standard for the settlor to be unrelated to you, and is often an accountant or solicitor.

Trust deed

- 54 The trust deed is the document containing the rules of the trust.
- 55 It sets out how the trust must be run, what the trustees can do in running the trust and who the Beneficiaries are.
- 56 It is necessary to review the trust deed periodically to ensure that it allows the Trustees to operate the trust in the most appropriate manner.
- 57 It is also important to review the terms of the trust deed carefully with particular reference to issues such as:
- a any consent requirements for decisions to be made;
 - b the vesting day (or ending day) of the Trust. In all states other than South Australia a trust can last for a maximum period of 80 years;

- c the appropriateness of the succession of the controller role (if any);
 - d the inclusion of sufficient powers to ensure the trust can make distributions in a tax effective manner;
 - e the powers the Trustee has in relation to administering the Trust; and
 - f the provisions that apply in the event a Trustee fails to make a distribution.
- 58 Generally, the terms of the trust deed are drafted as broad as possible to provide the Trustee with sufficient flexibility to manage the trust property. However, this may not always be the case, and the trust deed should be reviewed prior to making relevant decisions for the trust (to ensure sufficient power is available to enter into intended arrangements).

Trustee powers

- 59 The legislation in each Australian state pertaining to trusts (**Trusts Acts**) provide a series of core powers to trustees regardless of the terms of any trust instrument, which can be relied on by trustees as powers of last resort where the terms of a trust deed are unknown.
- 60 Generally, the statutory powers for trustees will include the ability to:
- a lend money;
 - b borrow money;
 - c deal with trust property;
 - d carry on a business; and
 - e otherwise conduct investments in accordance with prudent best practice.
- 61 On any test, the trustee's powers contained in the relevant Trusts Acts are at best limited in comparison to the powers generally provided by a modern trust deed. It is therefore recommend that the Trustee relies on the trust deed in relation to exercising all powers.

Taxation of trusts

- 62 A trust is not a separate legal entity for tax purposes.
- 63 Rather, the trustee is required to calculate its 'net income' as if it were a separate taxpayer for the purposes of tax law.
- 64 That said, the trustee is able to distribute such income to beneficiaries of the trust and those beneficiaries are subsequently taxed on the income (or capital) received from the trust.
- 65 Broadly:
- a Beneficiaries will then include such income when they prepare their tax return.
 - b Any income not distributed by the Trustee to the Beneficiaries by 30 June will be taxed to the Trustee as trustee for the trust.
 - c The tax rate for any income left in the trust on 30 June will be the highest marginal tax rate.
 - d The underlying assets of the trust can also be distributed to Beneficiaries.
 - e Tax advice should be sought at the relevant time as there are various different ways such a distribution could be treated from a tax perspective.

- 66 The taxation of trusts are complicated and specialist tax advice should be obtained prior to making distributions.
- 67 We strongly recommend you contact your accountant prior to June each financial year to discuss the appropriate strategies in relation to the intended distribution of the trust's income by 30 June.
- 68 Any amounts not distributed will be subject to the 'default' provisions mentioned above.
- 69 Additional tax issues to consider include (but are not limited to):
- a the fact that generally children under the age of 18 are only eligible to receive up to \$416 tax free from trust distributions;
 - b the dealing of any amounts unpaid from the trust intended to be distributed to beneficiaries (in otherwise, dealing with 'unpaid present entitlements' or loan accounts);
 - c reimbursement arrangements that contravene anti-avoidance measures; and
 - d discrepancies from what the trust deed states can be distributed and the taxation definition for 'net income'.
- 70 Further, you should appreciate the effect trusts have on various other taxes and advice should be obtained from your tax advisor. These can include (but again, are not limited to):
- a if your trust operates a business – payroll tax; and
 - b if your trust owners real property – foreign surcharges for stamp duty and land tax.
- 71 Please let us know if you would like our assistance with any of the above.

Administration

- 72 As a trust is a relationship, it is crucial that you understand the Trustee acts as the person looking after the trust fund/property for the Beneficiaries.
- 73 This means that the Trustee's name should be listed as the owner of the trust fund/property. Notice should also be given that the Trustee holds such assets for the benefit of a trust.
- 74 It is important to ensure the correct name is used, and at least initially, you should use '**Trustee Name as trustee for Trust Name**' when advising third parties of the legal owner of the asset.
- 75 Please ensure a bank account is opened in the name of the Trustee acting as trustee for the trust.
- 76 Records of significant Trustee decisions should also be retained with the original of the trust deed.
- 77 Additional documents prepared affecting the terms of the trust should also be kept with the original of the trust.
- 78 Please ensure that any documents signed are signed by all parties in writing (i.e. not electronically) to reduce any potential invalidity arguments.
- 79 Please be aware that whilst ordinarily the Trustee is not required to disclose its decisions to the Beneficiaries of the trust, the Beneficiaries may be entitled to request some reasonable documents in relation to the operation of the trust.

- 80 Financial statements must also be prepared for trusts and tax returns lodged.
- 81 Upon a change of Trustee, the retiring trustee must ensure all records relating to the trust are transferred to the new Trustee, and this is often outlined in the document effecting such a change.

Asset protection

- 82 A relevant factor in utilising trusts are the 'asset protection' benefits.
- 83 In this regard, however, and mentioned above, please note that the Trustee of the trust does carry risks.
- 84 Therefore, it is usually recommended that if the trust conducts risky activities (by way of operating a business or holding 'risky' assets such as real property), that the Trustee be a company.
- 85 This segregates risks of the trusts to the company and provided there are no breaches of director duties, then the risks do not flow to the director of the company.
- 86 We also note that on the basis the Beneficiaries of the trust have no right to any of the assets of the trust, then they are not liable to the liabilities of the trust. Please be aware this position may differ if it can be proven, or for trusts where Beneficiaries have a fixed entitlement to the assets of the trust.
- 87 The Appointor role also carries no risk as no property is held in that capacity.
- 88 Our above comments relates to the 'bankruptcy' risk in a trust.
- 89 In relation to family law breakdowns, assets of the trust can either be considered as matrimonial property or a financial source for a party to the marriage, meaning that they would be considered in one way or another in the case of separation.
- 90 Best practice to reduce the effect of trusts in a relationship, would be to obtain binding financial agreements.
- 91 Whilst steps may be taken to reduce the potential for trusts to form part of the assets considered from a relationship breakdown, ultimately, family courts are provided with broad powers to decide on the fairest way to split assets of the trust.

Succession planning

- 92 We recommend you understand how control in the Trust passes.
- 93 Specifically, you should ensure you understand who takes over the Trustee and Appointor role for the trust.
- 94 Generally, the trust deed will outline a default position on who takes control on the passing of one or all of the trustees.
- 95 The trust deed, however, must be reviewed to confirm this position. Where the trustee is a company, the company constitution and shareholders must be reviewed to understand who takes control over the trustee company.
- 96 Trust deeds can either include a provision enabling you to specifically state who you wish to succeed the current trustee/controller. Alternatively, if this is not specifically stated, a default position such as either:
- a the surviving Trustees/Appointors; or

b if there are no surviving Trustees/Appointors, then the legal personal representative of the last surviving Trustees/Appointors, could apply.

97 Where such a position does not align with your intentions, then additional documents may be required to ensure the appropriate successor is appointed.

Company summary

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- 3 The below information is not intended to be an exhaustive list of company law but rather a detailed summary of the key company law issues you should understand and be aware of.
- 4 If you would like more specific advice in relation to proposed transactions in relation to your company, please ensure you obtain specialist advice prior to undertaking such transactions.

Company

- 5 Unlike partnerships and sole traders, a company is a legal entity separate from its shareholder owners.
- 6 People are appointed as directors to make the legal decisions for the company.
- 7 Generally, directors are responsible for the management of the company. This includes making the day to day decision making of the company and approving procedural aspects of the company.
- 8 The shareholders (as mentioned above) are the owners, and the people who ultimately derive the benefits generated by the company.
- 9 The Company relates to a 'proprietary limited company'.
- 10 A proprietary limited company requires a minimum of one director and one shareholder and not more than 50 shareholders who are not employees. The director and shareholder can be the same person. At least one director must be ordinarily resident in Australia. A company secretary is not required by law, but if one is appointed it is possible for that person to be a director as well. The maximum number of non-employee shareholders is limited to 50. If more are wanted, a public company must be set-up.
- 11 Restrictions apply to proprietary companies about fundraising. Proprietary companies cannot raise funds by engaging in any activity that requires any form of disclosure document to be issued, such as a profile statement, offer information statement, or prospectus.

Corporations law – who can be an office holder

- 12 A director must be an individual, not a company, and be at least 18 years old. The written consent from the director must be obtained, which should be kept with the company's records. It does not need to be filed with ASIC.
- 13 A person must not act as a director or secretary or manage a company without court consent if they are:
 - a an undischarged bankrupt or the subject of a personal insolvency agreement or an arrangement under the Bankruptcy Act 1966 that has not been fully complied with;
or
 - b have been convicted of various offences such as fraud or offences under company law, such as a breach of the duties of a director or insolvent trading.

- 14 If a person has been convicted of one of these offences, they must not manage a company within five years of their conviction. If imprisoned for one of these offences, they must not manage a company within five years after their release from prison.
- 15 If a person becomes bankrupt, enters into a personal insolvency agreement or is convicted of a relevant offence at a time while they hold the office of a director or secretary of a company, then they are automatically removed from office.
- 16 The company must then notify ASIC that this person is no longer a director or secretary of the company. ASIC can also ban a person from being a company director in certain situations. If a person is not allowed to be a company director or secretary, then they are not allowed to manage a company. It is a serious offence to set-up dummy directors for another person who really manages the company.
- 17 Under section 206G of the Corporations Act 2001 (the **Act**) a person who is disqualified following conviction for an offence or insolvency rather than disqualified by ASIC may apply to the court for leave to manage a corporation. The court may set aside the automatic 5-year disqualification if satisfied that there are considerations in favour of such an order: *Re Colin Gregory Ryan* [2014] QSC 18.
- 18 If disqualified by ASIC under Part 2D.6 then ASIC may give a person who it has disqualified written permission to manage a particular corporation or corporations. The permission may be expressed to be subject to conditions and exceptions determined by ASIC.
- 19 Please also be aware there are potential people who may still be considered as directors even if they are not listed as a director. Similar to the 'dummy director', if the person acting from the 'shadows' is considered to be making the decisions for the company, then that person will be deemed to be a 'shadow director' and the duties as discussed below may apply to them as well.

Corporations law – director duties

- 20 Given the nature of a director's role in a company, in that there is an opportunity for the directors to act in a manner that benefits themselves over the company, duties have been developed under law and embedded in legislation.
- 21 That is, directors owe both statutory (being held via legislation) and common law duties to the company and its shareholders.
- 22 These general duties have been developed to ensure the decision making of directors are made with an appropriate level of diligence, thereby providing some form of protection to the shareholders.
- 23 A general rule of thumb to ask when determining if a director is acting within their duty is to question whether the directors believe they were acting in the best interest of the company.
- 24 As an example, the case of *Spedley Securities Ltd (in liq) v Greater Pacific Investments Pty Ltd (in liq)* (1992) 30 NSWLR 185 relates to certain transactions entered into for the purpose of disguising the true state of the accounts of Spedley Securities, and was held to be dishonest and amounted to a breach of directors duty at common law, as well as the legislation at the time.
- 25 A more recent exact is the case of *ASIC v Cassimatis (No 9)* [2018] FCA 385 where up to \$70,000 in penalties was levied on the directors of Storm Financial. They were also disqualified from managing corporations. The case related to reckless financial advice provided by the directors that resulted in them breaching their duties owed to the company

by exercising their powers in ways which caused or permitted inappropriate advice to be given to investors. This resulted in a breach of the 'care and diligence' obligations imposed under the Act (as further outlined below).

- 26 Serious penalties for breaches of director duties include fines, imprisonment and being prohibited from acting as a director.
- 27 Common law duties include to:
- a act bona fide in the interests of the company as a whole;
 - b not act for an improper purpose;
 - c exercise care and diligence;
 - d retain discretion;
 - e avoid conflicts of interest;
 - f not disclose confidential information; and
 - g not abuse corporate opportunities.
- 28 Statutory duties include but are not limited to (note all references to sections below refer to the Act):
- a Section 180 – Care and diligence - civil obligations;
 - b Section 181 – Good faith - civil obligations;
 - c Section 182 – Use of position - civil obligations;
 - d Section 183 – Use of information - civil obligations;
 - e Section 184 – Good faith, use of position and use of information - criminal offences;
 - f Section 191–195 – Disclosure of, and voting on matters involving, material personal interests;
 - g Section 197 - Liability for debts incurred by a trustee company when the trust has no assets, or insufficient assets, to indemnify the trustee;
 - h Section 208–210 – Member approval for related party financial benefits; Section 285–318 – Financial reporting;
 - i Section 588G – Director's duty to prevent insolvent trading by company;
 - j Sections 1041E-1041H - Knowingly or recklessly disseminating false or misleading information, which is likely to have the effect of inducing people to deal with shares in a company; inducing another person to deal in securities by publishing false or misleading statements, promises or forecasts, or by dishonestly concealing facts and engaging in dishonest conduct, or misleading or deceptive conduct in relation to securities.
- 29 Each of the above duties have a history of case law to define the boundaries of the general duties, but you should be aware of their general obligations, and should seek advice if you decide to exercise decisions in your role of director in a way to contravene those duties.

- 30 Important in considering the director's duties, section 180(2) of the Act provides the business judgement rule, which requires directors to meet the following conditions when making a decision:
- a make a judgement in good faith for a proper purpose; and
 - b do not have a material personal interest in the subject matter of the judgement; a
 - c inform themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate; and
 - d rationally believe that the judgement is in the best interests of the corporation.
- 31 Note a director's belief that the judgement is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.
- 32 In this regard, note that Australian courts have been reluctant to interfere with directors' judgements in questions of business management (*Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483).
- 33 There is a limit, however, that aligns with the US law, and relates to when directors enter into transactions where:
- a they had an unauthorised interest in a transaction of the company;
 - b had not informed them in an appropriate extent about the subject of the judgement;
 - c did not act in good faith or for a proper purpose; or
 - d acted in a manner that a reasonable director with their training could not possibly regard as being for the benefit of the company.
- (*Aronson v Lewis* (1984) 473 A 2d).
- 34 Please note the broad protection in the Act is intended to stimulate risk taking, innovation and other creative entrepreneurial activities.
- 35 There may also be times when a director can be liable for company debts, which can include but are not limited to:
- a when a company is in liquidation:
 - (A) insolvent trading compensation claims made by a liquidator or creditors;
 - (B) unreasonable director-related transactions claims made by a liquidator;
 - (C) loss of employee entitlement claims made by a liquidator or creditors.
 - b whether or not the company is in liquidation:
 - (A) breaches under various legislation relating to but not limited to: workplace health and safety, PAYG taxation, superannuation contributions debts, trade practices, racial discrimination, criminal conduct and the securitisation of personal property;
 - (B) claims under personal guarantees.
- 36 Section 189 of the Act provides protection for directors when they rely on information or professional or expert advice given or prepared by:

- a an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned;
- b a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence;
- c another director or officer in relation to matters within the director's or officer's authority; or
- d a committee of directors on which the director did not serve in relation to matters within the committee's authority,

provided that reliance was made in good faith and after making an independent assessment of the information or advice having regard to the director's knowledge of the corporation and the complexity of its structure and operations.

37 Officers' reliance on advice they obtain will be reasonable if:

- a in good faith, after making an independent assessment of the advice, having regard to:
 - (A) the officers' knowledge of the company;
 - (B) the complexity of the issue; and
 - (C) the operations of the company;
- b it relates to whether the original reliance was reasonable and arises as part of proceedings investigating if the officers performed their duties under the Act or at law.

38 In order to satisfy the requirement of an "independent" assessment, a director must at least consider relevant views and material and bring his or her own judgement to bear in relation to the matter, and the case of ASIC v Macdonald (No 11) (2009) 256 ALR 199. In that case, an officer failed to make out the elements necessary to fall within section 189 of the Act in the absence of evidence he had relied upon advice of other executives or that he had independently assessed any such advice.

39 In this regard, section 189 of the Act does not exclude a director's obligation to be involved in the company's management and to "take all reasonable steps to be in a position to guide and monitor, including taking a diligent and intelligent interest in the company's financial statements.

40 Also consider Morley v ASIC (2010) 274 ALR 205 which relates on how senior employees of a company must ensure sufficient information is relayed to the board of directors when evaluating critical decisions. In that case, it related to the ASX announcement from the James Hardie Group about a foundation to fund claims for illnesses related to asbestos that was determined to be misleading. The board should have taken additional steps than to relay on the recommendations by the senior employees of the company.

41 Given the obligations imposed on directors, it is common for directors to sought out insurance to cover certain circumstances if they are exposed in their role as director. This will be discussed further below.

42 It is also common for various parties to request guarantees from directors when a company takes actions (e.g. taking out a loan or selling assets from the company). Advice should be sought whenever you are requested to provide a guarantee as accepting a guarantee can expose your personal assets to the actions of the company.

Company secretary

- 43 A public company needs a company secretary, but this is optional for a private company. If a secretary is appointed, they must reside in Australia. The secretary can be the same person as the director. In a one-director company, it is common for the same person to be both the sole director and sole secretary. It is necessary to obtain the written consent from a secretary, just like a director.
- 44 Please note that the directors of a company have the ability to appoint the company secretary (section 204D of the Act), and that the secretary can be liable for contraventions by the company, under section 188 of the Act, which lists out the secretary's responsibilities (including ensuring the company records are kept up to date and appropriate forms are lodged).
- 45 A summary of the secretary's tasks are as follows:
- a act as the 'chief administrative officer' and, in particular, perform roles such as an office manager, public officer, accountant, financial controller and public relations officer;
 - b ensure that the company's constitution and of the Act are complied with;
 - c ensure that all ASIC requirements are complied with;
 - d organise and attend meetings of shareholders and directors;
 - e ensure that meetings comply with the company's constitution and the of the Act;
 - f manage all transactions involving shares;
 - g ensure that the company's financial records are kept in accordance with the of the Act;
 - h oversee compliance with the taxation and revenue regimes;
 - i manage the company's insurance program; and
 - a be responsible for secure storage of any seal.
- 46 Some contraventions that company secretaries can be personally liable can relate to issues regarding:
- a having a registered office;
 - b various ASIC notifications; and
 - a other potential issues arising out of the specific duties they perform, with reference to a number of the issues outlined above.

Shareholders

- 47 Every company must have at least one member, that is, one shareholder.
- 48 Any legal entity may hold shares in a company. This includes any person, company, trust, incorporated association or partnership resident anywhere in the world. A child under the age of 18 years can only hold shares through a trustee or guardian. A trust or superannuation fund can only hold shares through its trustee. A proprietary limited or limited company may be a shareholder in another company. There is no minimum share capital required to incorporate a new company, although there has to be at least one share on issue at the time of formation.

49 Please also note that shareholders of 'proprietary limited company' are only liable for the value of their shares in a company should a company go bankrupt.

50 Below is a quote from a very old case that continues to reflect the current law in terms of shareholders liability for companies:

*The company...is a distinct person from its shareholders. **The shareholders are not liable to creditors for the debts of the company.** The shareholders do not own the property of the company...*

The King v Portus; ex parte Federated Clerks Union of Australia (1949) 79 CLR 42

51 Although the case states that shareholders are not liable to creditors for the debts of the company, the company itself may be bankrupted from the debt leaving no value in the shares of the company.

Public officer

52 A company must appoint a 'public officer' within three months of commencing business or deriving income from property in Australia, and notify the Australian Taxation Office of the appointment, also within the three-month period. The Public Officer must be a natural person ordinarily resident in Australia and be at least 18 years old. The Public Officer is responsible for ensuring that the company complies with the tax law and for liaising with the ATO concerning the company's taxation matters. See s 252 of the Income Tax Assessment Act 1936.

Registered office

53 All companies need a registered office in Australia: s 142 of the Act. This is often the office of the company's accountant or lawyer. A home address will suffice. For a proprietary company the office does not need to be open to the public. However, it is a place where documents can be legally served on the company, so it cannot be a post office box. If the company does not own or lease the office, it is necessary to obtain the occupant's written consent for use as the registered office and the company's name and the words "Registered Office" must be prominently displayed.

Company constitution

54 Broadly, a company's constitution is threefold, being

- a to displace or modify one or more replaceable rules (which are in the Act);
- b to adopt a replaceable rule that does not otherwise apply to the company; or
- c to address matters upon which the Act is silent.

55 Please note the governing rules of a company can be a combination of the replaceable rules in the Act and constitution, per section 134 of the Act.

56 That said, directors duties do not form part of the replaceable rules, so the constitution will relate to amending the powers a director may exercise.

57 Generally, the constitution will refer to replaceable rules that they continue to adopt, and will only vary replaceable rules if there are practical reasons for the variation.

Officeholder consent and company register

58 Section 201D of the Act requires a director to consent to their appointment before being appointed.

59 The company is then required to retain a copy of the consent. Practically, this should be kept on the company register which should contain all details of changes to the company.

60 Other than the director appointment, the company must keep financial records for a period of 7 years which includes receipts and invoices.

Director meetings

61 Ultimately the requirements for conducting a director or general meeting will depend on the terms of the constitution for a company, and the replaceable rules (if necessary).

62 If a constitution does not override the Act, then Chapter 2G of the Act will apply.

63 In this regard, rather than set out the entire legislation again, it is important to differentiate between the different ways a director (or shareholder) may make decisions. These can be separated into meetings and resolutions.

64 If calling on a meeting, steps must be taken to ensure a meeting is called in accordance of the rules of the company, which may require certain notice to be provided.

65 Once decisions are resolved in the meeting, the chairperson will sign a minute of meeting as evidence of the decision.

66 In contrast, resolutions do not necessarily require a meeting to be called, and having all directors sign the resolution will generally effect a valid decision (subject to the rules of the company).

67 For example, if there is insufficient time to call a meeting of directors, if all directors arrange to resolve a decision, a decision can be made without having to follow the mechanisms of calling a meeting.

Power of attorney - companies

68 A corporation may expressly or impliedly authorise an agent to enter into a contract on its behalf; and the corporation has all the powers of a legal person, such as the power to grant a power of attorney recognised by the common law.

69 When a corporation grants a power of attorney, the instrument should be executed in the corporation name and if no company seal is affixed, then the name and the ACN or ARBN of the corporation must be shown in the execution. Powers of attorney instruments not executed in this way will be requisitioned. The usual legal and practice requirements for the execution of instruments by companies also apply to powers of attorney.

70 A corporation may be appointed as an attorney. A lease or mortgage often contains a general power of attorney conferred upon a corporation, but such a document must be reviewed.

71 A trustee company may be appointed by an individual or company to act as an attorney. Those powers are exercised by an officer of that trustee company.

Power of attorney - directors

72 Although most constitutions permit the appointment of an alternate director, not many permit the appointment of an attorney by a director.

73 A general power of attorney by a director does not enable the attorney to exercise the donor's directorial duties. The donor is not empowered to make the delegation.

74 The company constitution may contain a specific power:

- a empowering a director to delegate their directorial duties which may then be effected by a power of attorney; or
 - b empowering the directors to resolve that a director may delegate his directorial duties which may then be effected by a power of attorney.
- 75 Constitutions prepared by us do not include such a power to avoid the potential of unwanted persons being automatically appointed as directors of companies via a power of attorney.

Systems

- 76 The directors of the company should obtain the financial statements of the company on a regular basis.
- 77 The directors are obliged to understand all financial statements and should seek advice if there are any concerns they have from time to time in this regard.
- 78 The directors also need to ensure that the company implements and maintains adequate financial systems to track all relevant data, including:
- a cash flow;
 - b cash on hand;
 - c receivables;
 - d revenues;
 - e creditors; and
 - f obligations for repayments to financiers.

Financial statements

- 79 The Act obligates some companies, mainly depending on their size, to prepare financial statements that comply with relevant accounting standards.
- 80 There are strict rules that apply, in relation to how the obligation for preparing financial statements is discharged; officers need to ensure that they understand them.
- 81 The Act may also impose an obligation for the financial statements of the company to be audited.
- 82 If this is the case, the directors have a positive obligation under the Act to assist the auditor and to maintain vigilance in relation to all aspects of the audit relationship.

Extracting value

- 83 There are various ways to extract value out from the company that can include, but are not limited to:
- a issuing a dividend;
 - b being employed by the company and receiving a wage;
 - c lending money out.
- 84 **You must however seek specialist tax advice before undertaking any of the actions above.**

85 There are various potential tax issues in extracting value out from the company that must be considered that include, but are not limited to:

- a 'Division 7A';
- b the value shifting rules;
- c various potential capital gains tax triggers.

86 We strongly you discuss the most appropriate strategy with your accountant prior to taking money from the company.

87 Further, without appropriate documentation evidencing how the money is paid out of the company, you leave yourself exposed should a dispute arise in the future in relation to the intended effect of the transfer of money.

88 That is, if you choose to lend money to yourself from the company, but do not have appropriate documents supporting such a claim (in addition to having the loan be on valid terms for the purposes of Division 7A), a dispute may arise in the future claiming a payment was made as opposed to a loan.

89 This may have significant tax consequences if it is unable to be substantiated. This was the case in *Rowntree v FCT* [2018] FCA 182.

90 There are also various bankruptcy provisions to be aware of when extracting value from the company and are intended to combat persons from extracting value before the company goes bankrupt, leaving the creditors with no assets to repay company debts.

91 If the extraction of value from the company can be seen as intending to defeat creditors from being repaid, we strongly recommend you obtain specialist advice in relation to the potential for such extract of value to be void.

92 Please be aware that the extraction of value can include preferential dividend payments.

Asset protection

93 Given the risks that are associate with acting as a director of a company, best practice is to ensure individuals holding a director role do not hold significant assets in their name.

94 This is to reduce the likelihood of assets being at risk if the director was sued due to their position in the company.

95 That said, the three steps that may be taken to negate a need to avoid holding personal assets are as follows:

- a taking the upmost care in undertaking the directors duties;
- b entering into deeds of access and indemnity (intended to limit the risk adopted by a director of a company, noting there are restrictions on what a director can be indemnified for under section 199A of the Act); and
- c obtaining insurance (mentioned above).

96 The reason to consider having a deed of access and indemnity relates to the potential gap between a director's indemnity and insurance policies. Is it these liabilities that the company will be required to indemnify its directors under the deed of access and indemnity where the company will not be covered by insurance.

97 One example is when a director seeks legal advice in anticipation of a claim, which may or may not be made against the director in the future. The policy will only respond to cover legal costs once the claim is made. A gap might also occur because the insurance policy provides cover for a maximum sum, whereas the indemnity offered by the company is unlimited.

Personal records

98 While the Act does allow past and present directors to access the company's books and records, in connection with legal proceedings brought against them, it is best practice for directors to retain all information that might be relevant to a decision, particularly if there is a concern that the decision might prove to be wrong.

99 Some of the information that should be retained includes:

- a diary notes of all relevant discussions;
- b private research carried out; and
- c any review or meeting notes.

Succession planning

100 From a succession law perspective, thought needs to be considered in relation to who should succeed the role of director. Often the shareholder of the company will retain the ability to appoint new directors (per section 201G of the Act), but a company constitution can be hardwired to require certain board compositions.

101 Below outlines the general position found.

102 When a director of a company dies, the surviving directors continue to manage the company pending the appointment of a new director by the shareholders of the company.

103 When the sole shareholder of a company dies, the directors continue to manage the company until the beneficiaries under the will have the shares transferred to them.

104 When the sole director is also the sole shareholder and they die, their executor, or other personal representative appointed to administer the deceased's estate, may appoint a new director to the company. See s201F of the Act. This director has all the powers, rights and duties of the deceased director and can keep the company running until shares are transferred to beneficiaries, who may then appoint new directors.

105 If there is no will, an application to the Supreme Court for letters of administration must be made. Until someone is properly authorised to act, the company may be unable to operate.

106 Regardless, the company constitution and other governing rules and relevant documents (such as Wills) must be reviewed to ensure there are no 'non-standard' clauses in the company.