

Succession planning for private companies

June 2018

For those wanting to ensure that a particular family member becomes the director of a family company when the current director passes, it's a minefield.

So, you have a private company (that's one with 'Pty Ltd' after its name). It might be the trustee of your family trust or your self-managed super fund or it might simply be the company that operates your small business.

You are a director of the company. You might be the only director or your spouse or some of your kids or even your business partner might be the other director/s. You control the company more or less through the shares in the company that you own, because in a standard company constitution the shareholders control the appointment and removal of directors.

Now let's suppose that you want a particular person to become the director of the company when you pass. It might be your spouse or one of your children chosen as part of your specific estate planning arrangements.

Whatever the reason, and there are many, you want that person to become the director in your place.

Seems easy enough? Actually, no. Much more complex than you would think.

The problem is that directorship and the right to be a director of a company is not 'property'. It is not an asset, a thing that can be owned. It is an office to which a person is appointed rather than property which can be owned and transferred.

So you can't just say in your Will "I give my directorship in my company to ...". That's like saying "I give my Presidency of the Rotary Club to my son" or "I give my Chairmanship of the P&C to my daughter". There's nothing to give because these things are not assets and on your passing you cease to hold those offices.

If you want to appoint your successor director you have to work out firstly how to do that within the scope of the laws and rules that apply to the operation of companies and then secondly how to ensure that the other shareholders and directors in the company will not undermine your wishes when the time comes.

If the company is a one-director/one shareholder company then things are a lot easier though there's still things to consider.

In that situation you give the shares in that company to the person you want to become the director and they can vote the shares to appoint themselves as director.

Section 201F of the Corporations Act 2001 (Cth) is relevant here and depending on the circumstances could be either positive or negative. That section allows a deceased director's Executor to appoint the successor director, including themselves. This power would be subject to the ability of the successor shareholder appointing the director so would only have effect if you haven't made that gift of the shares in your Will or you have directed that those shares be held by the Executor.

So, in single director/shareholder companies it's best to specifically gift the shares and not leave it up to others to decide what will happen to the shares and therefore the directorship of the company.

In companies where there are more than one director and more than one shareholder things get more interesting.

Simple statements in the constitution of the company or the trust deeds of the family trust or the super fund do not have the necessary power at law to ensure that the person you have chosen to take over your role as director will in fact be so appointed.

For example, if you don't give that person a majority shareholding then the remaining shareholder/s can change the constitution to take out any such direction. Perhaps the same with any trust deed.

And in any case the trust deed is the rule book for the trust. It does not have the power to deal with the corporate issues relating to the trustee any more than the constitution of the company can outline the terms of any trust that the company takes control of. These are separate structures with different roles and separate constituent documents not capable of dealing with one another's issues.

You can put a clause in the company's constitution appointing the successor director and making that clause unchangeable. But what often happens is that every so often you decide that the constitution is out of date and should be completely changed and you adopt a whole new constitution not remembering the successor director clause. Is the change then effective? Does the original clause carry over to the new constitution? By what mechanism? Off to court for directions.

There's even the view that you could put the same sort of clause in the trust deed but the same arguments apply as to whether the deed has the necessary power over its trustee and what would happen if the deed is amended 'in globo'.

So if you can't do it by Will, constitution or trust deed how can you appoint your successor director with any confidence?

The answer lies in making the appointment now, stipulating that it will only take effect on your passing and ensuring that the appointment can't be changed by the other shareholder directors when the time comes.

Pass a shareholders resolution appointing the successor director (do you need a substitute appointment in case the successor director is unavailable at the time?).

Ensure the successor director signs a consent to act as director in the appropriate form.

If the company is the trustee of a self-managed superannuation fund ensure the successor director signs all the necessary ATO forms and declarations to become a director of an SMSF trustee and is not a disqualified person.

State that the shareholders resolution is irrevocable without your consent which right to consent dies with you (so your Executor can't consent to a change in order to stymie your appointment).

Don't use directors resolutions because directors are much more limited in their power to fetter their future acts as a result of their obligation to comply with their considerable statutory and common law directors duties.

Importantly, have the other shareholders execute a deed declaring that they will give effect to your appointment when the time comes.

If shareholders change before the appointment takes place you may need to renew the deed with the new shareholders.

This process is clearly cumbersome, but it may be the only way that you have any chance of stopping the other shareholder directors from getting around your appointment for whatever reasons they may have.

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.