

Directing a company

What does it really mean to be a director of the company? Is there a responsibility attached to the title and what are the potential exposures faced? **Tas Demos** provides some answers.



Tas Demos

In real estate, the majority of businesses are conducted through a company structure, with the owner of the company usually also being the director.

Generally, control of a company lies with the shareholders, but the directors have wide powers to control the company's organisation and business.

This control is governed by the company's constitution and certain provisions in the Corporations Law.

In New South Wales, it is a requirement of the Property, Stock and Business Agents Act 2002 that one director of a real estate company is also a licensed real estate agent. Invariably, real estate agents who operate their businesses through companies will need to understand the role of director:

Who may be appointed?

Any natural person over 18 years of age can be appointed as director of a company, but only after consenting to act in that capacity. The consent must be in writing and kept by the company.

An individual cannot be a director of a company if he or she is insolvent, under administration or has been convicted of any offence:

- In relation to the promotion, formation or management of a corporation
- Involved in a serious fraud or committed for defrauding someone.

Directors' duties

Directors' duties can be divided into two groups:

1. Common law fiduciary duties

Directors owe their company the fiduciary duties of loyalty and good faith. The fiduciary duties are owed to the company and not to the individual shareholder.

The duty to act in good faith is made up of two components:

- a. the duty to act bona fide for the benefit of the company
- b. the duty to avoid conflicts of interest.

The first of these aspects relates to the obligation of the director to use his or her powers and position bona fide for the benefit of the company.

The second aspect of the duty of good faith is that the director is obliged to prevent a situation arising where there is possibly a conflict between his or her personal interests and those of the company.

2. Statutory duties

The statutory duties of a director can be separated into two components:

a. Administrative Duties

- There are also a number of certain administrative requirements of the company that the directors are responsible for. These include:
- The duty to ensure accounting records are correctly recorded such that the company's financial position can be explained. This not only extends to the trading records of the business but also to the trust account records
 - The duty to prepare a profit and loss account and balance sheets so as to present a 'true and fair' view of the company's affairs
 - The duty to ensure documents relating to changes in the company's constitution or officers are filed.

In addition to the duties imposed by the Corporations Law, company directors also have duties imposed on them by a range of other Federal and State laws.

b. Statutory duties of care and diligence

In addition to common law fiduciary duties, directors have a statutory duty to exercise the degree of care and diligence that a reasonable person in a similar position would exercise.

There are criminal sanctions against directors or other officers of a company who are reckless or intentionally dishonest and who fail to exercise their powers and discharge their duties in good faith in the best interests of the corporation or for a proper purpose.

Recent cases against high profile directors is indicative of the approach the Australian Securities and Investments Commission is taking in relation to the obligations and duties of directors.

However, although the Corporations Law imposes statutory duties of care and diligence upon the directors of a company, they can be protected by what is known as 'the business judgement rule'.

This rule provides that a director of a company who makes a business judgment or decision is taken to meet his or her duty of care and diligence,

and their equivalent duties at common law, in respect of the judgment or decision if they:

- make the judgement in good faith for a proper purpose
- do not have a material personal interest in the subject matter of the judgement
- inform themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate. It is a directors' responsibility to ensure they have a proper understanding of the issue at hand
- rationally believe that the judgement is in the best interests of the corporation, that is, a belief that a reasonable person in their position would hold.

If a director relies in good faith on information, or professional or expert advice, the director's reliance on the information or advice is taken to satisfy his or her statutory and common law duties.

Liabilities and offences of directors

If a director has executed his or her statutory and fiduciary duties properly and in accordance with the discussion above, then it is unlikely that they will be prosecuted or have legal action taken against them personally.

That is unless the company incurred a debt whilst the directors have known

or should have known that the company was not able to pay its debts as and when they fall due. This is known as insolvent trading.

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If there is a breach of duty in respect of insolvent trading, a director may be ordered to compensate the company. Their action may also result in a civil penalty or even criminal prosecution.

In addition to insolvent trading, there are a number of other offences where directors can be personally liable.

Directors may also be prosecuted for various offences, such as:

- obtaining a financial advantage
- dishonesty
- making a false or misleading statement
- providing false or misleading information or documents.

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Recent examples of convictions for defrauding the Commonwealth under s29D of the Crimes Act involve:

- major understatement of income over a number of years
- the use of 'Phoenix' companies, in which large tax debts are accumulated and the companies then liquidated, with the assets being transferred to new companies and tax liabilities left unpaid
- major failures to remit tax instalments for cash payments made to employees and subcontractors over a long period
- stripping of company assets by diversion of unpaid group tax instalments to fund an extravagant lifestyle
- claiming of substantial company deductions for moneys diverted to the controller's own use over a number of years.

Apart from the general criminal provisions noted above, there is an important rule which applies specifically where a 'taxation offence' is committed by a company.

Generally, anyone who is concerned with the management of the company is deemed to have personally committed that offence. This includes directors of a company.

It will be a defence to such a charge if the director proves that he or she:

- did not aid, abet, counsel or procure the relevant act or omission of the company, and
- was not, in any way, knowingly concerned in the company's act or omission, or a party to it.

Under tax law, the onus is on the director to establish, on the balance of probabilities, that he or she was not knowingly concerned

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It is unlikely that a director will be able to establish this defence by adopting an attitude of passive ignorance.

As a general policy, the Tax Office has said that it will prosecute the company rather than its directors. However, prosecution of directors may be appropriate where:

- prosecution of the company would be pointless because it does not have sufficient assets
- directors were deliberately using the company for the purpose of defeating the operation of the tax laws, or sheltering behind the 'corporate veil', or
- previous experience suggests that prosecution of the company would not have a deterrent affect.

It should not be assumed, however, that these are the only circumstances in which officers will be prosecuted.

In setting the penalty for revenue offences of this kind, the courts will take some account of the director's good character, but not to the same

extent as in general criminal cases. The importance of general deterrence will usually take priority over personal considerations.

In conclusion

In the vast majority of cases, directors of companies, especially smaller ones, are not aware of the responsibilities and obligations of the role or director until such time as they have breached their duties in some form or another.

Typically individuals believe that because they operate a business using a corporate structure they are safe from the threat of legal action. This will generally be the case as long as they do not breach their duties as directors. ■

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