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Infants as Corporate Shareholders in Family Corporations: The Position in Malaysia

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ABSTRACT

Background: Family business owners sometimes incline to have their family members to benefit from the business by making them as shareholders in the incorporated family business. Infants or minor children are not excluded from being given similar opportunity to have such stake in the company. The Act 777 (Companies Act 2016) does not prescribe the age requirement for a person to effectively become a shareholder in a company. **Objective:** This paper investigates the issues regarding the legality of infants to own shares in family corporations, and the implications arising pursuant to their status as shareholders. **Results:** The study reveals that although there is no statutory restrictions in the Act 777 alone for an under-aged person to hold shares, infants are exposed to various legal consequences as shareholders. **Conclusion:** Such legal consequences entail deep consideration by

the family especially parents or guardians before they ultimately decide to make their infants as shareholders in their company.

INTRODUCTION

Having own infant involved in a family business may lead to several advantages: often, the infant shares family business values and develops commitment and interests to the business at early age. While it seems to be a good idea to turn an infant as a shareholder in a family business corporation, the legality of infants owning shares should be scrutinized and other issues that can arise when corporate shares are placed in the hands of minors should also be well-examined. It is imperative to explore the legal position in various jurisdictions to appreciate the practice of allowing or disallowing infants to be involved in business as corporate shareholders or members. Masters (n.d.) is of the view that shares can legally be registered in the name of an infant if there is no law restricting the practice and she suggests that the position would depend on the law being enforced in the respective states. As for other jurisdiction such as in India, Das (2017) states that there is no law prohibiting an under-age person from becoming a shareholder in company, although such person is restricted from buying shares directly from the company and can only be a shareholder through his or her guardian. Similar position is applicable in Canada where infants may become the beneficial owners of properties including shares in a company and normally the trustee or guardian is named in the registration, or by other mechanism. There is however nothing in the Business Corporations Act which specifically prohibits an infant from becoming a registered owner of shares of a company, and this is in view of the both terms 'shareholder' and 'registered owner' refer to persons, and they would include minors (Pakrui, 2012). In England and Wales, the law does not prevent an infant from owning certain types of assets but an infant lacks in legal capacity to enter into legal contract which means a child could renounce obligation placed upon them by owning shares, or effectively turning their back on the shares. This is a particular problem where shares are nil paid or partly paid, as the child could choose to give up the shares when a call is made by the company (Korchak, 2016). In other words, the infant can reject or set aside the agreement for the shares while they are still under the age of 18 as there is no prohibition on such person under the age of 18 to hold shares in a company (O'Reilly, 2011). In Australia, it is entirely possible for children to own shares by way of beneficial ownership. Since infants are minors or under the age of 18, an adult must hold the shares for the infant until they are 18, and yet the infant is still entitled to receive and enjoy the economic impact from the shares (Davis, 2017). The above positions suggest that it is possible for infants to become shareholders in companies based on the law governing shares and corporations. The position will however be different when the legal capacity of the infants is taken into account as infants are not capable of entering into contracts. This nevertheless does not ultimately prevent infants to benefit from the entitlements as shareholders in numbers of jurisdictions provided that the law allows the practice and proper mechanism are in place to safeguard the beneficial interests over the shares on behalf of the infants.

METHODOLOGY

The study is based on qualitative approach which employs library research method for data collection. The study analyses various texts such as statutes, books, journals and reports.

RESULTS

Based on the study conducted, the Act 777(Companies Act 2016) is silent on the issue of legality for an under-aged person to hold shares in the family business corporation. However, infants are deemed to be legally incapable of holding shares based on the rule of competency to enter into a contract. 'Living Trust' on the other hand offers option for infants to enjoy the benefit of shareholding as the named beneficiaries upon execution of respective trust deeds. The construction of 'Living Trust' allows for an orderly and properly succession of business and stakes in the family company so that the infants can eventually take over and resume the business when they become legally capable to do so in future. It is worth to note that there are consequences to the trust which may affect the position and interests of the infants as beneficiaries to the shares which are fully highlighted and discussed in this paper.

DISCUSSION

Legal Capacity to Hold Shares in Malaysia

It is very important to understand the effect of becoming a shareholder of a company. The fact that a person holds share in a company, he becomes the proprietor of the company and have the power to exercise certain rights in the company. There has been argument saying that people under the age of majority can own personal property in their own name, although a person's minority status may affect his ability to use the property. Masters (n.d.) is of the view that since corporate law does not restrict ownership of shares to adults, stock in small corporation or family business can legally be placed in the minor's name by recording the child as the registered owner of the shares in a corporation's stock register.

So, whether the position is the same in Malaysia? Mohd Sulaiman et al. (2008) states that any legal person can be a member of a company which may include either natural or artificial persons. The Act 777 nevertheless does not statutorily describe as to whether an infant has the capacity as legal person to hold shares in a company. W. M. Chan (2017) however proposes that for a natural person, he should have attained the age of 18 when he becomes a member of a company. This is in view of the effect of company's constitution which is considered as a statutory contract between the company and members, as well as members and other members, as stipulated in section 33(1) of the Act 777. Pursuant to such provision, members or shareholders are considered to be contracting parties and they should have the capacity to legally contract with one and another.

Rule of Competency to Enter into Contract:

In order to determine the legal position relating to infant's capacity to contract, and thus able to own shares, the paper will analyze the relevant provisions of the Act 136 (Contracts Act 1950), the Act 21 (Age of Majority Act 1971) and the Act 611 (Child Act 2001).

Firstly, the examination of provisions in the Act 136 pertaining to the age. Section 10 provides to the effect that every person who is competent may enter into a contract. It is followed by section 11 which provides that a person is competent to contract when he attains the age of majority according to the law to which he is subject to. Then, second question follows ie what is the age of majority according to Malaysian law? Section 2 of the Act 21 provides that all persons in Malaysia attain the

age of majority at 18. In line with this, section 2 of the Act 611 also defines child as a person under the age of 18.

The above highlighted provisions conclude that a person attains the age of majority when he reaches 18 and consequently becomes competent and has the capacity to enter into a contract.

Effect of A Contract Entered into by Infants:

Based on the earlier deliberation on the rule of competency, one might state that an infant who is below the age of 18 is not competent to enter into a contract including the contracts or agreements that relate to shareholding in a company. Although the Act 136 does not expressly stipulate the effect of an agreement entered by an infant, the courts in Malaysia ruled that the effect of sections 10 and 11 of the Act 136 render all such contracts void.

However, in the Indian case of *Mohori Bibee v Dhurmodas Ghose* (1903) ILR 30 CAL 539, the Privy Council held that the combined effects of section 9 and 10 of the Indian Contracts Act 1872 which is in *pari materia* to sections 10 and 11 of the Malaysian act namely the Act 136, rendered such contracts void. In that case, the appellant through his agent lent the infant (respondent) the sum of 20,000 rupees at 12% interest and secured the loan by way of mortgage executed by the infant in favour of the appellant on some houses belonging to the infant. The appellant's agent knew that the respondent was an infant. Later the infant by his mother, as his guardian and next friend, commenced action for a declaration that the mortgage was void for lack of capacity. It was held that the contract of loan was void.

The contractual incapacity of an infant is regarded as a protection of the infant against the consequences of its own action and presumed lack of judgment in such matters. In *Tan Hee Juan v The Boon Keat* (1934) MLJ 96, the High Court applying the decision of the Privy Council established earlier in the *Mohori Bibee's* case, agreed that contracts by infants are void.

In a later case of *Government of Malaysia v Gurcharan Singh* [1971] 1 MLJ 211, the Plaintiff sued the first defendant as the promisor and the second and third defendants as sureties for breach of agreement in writing entered into by them with the plaintiff for providing a course of training at a Malayan Teacher's Training Institution. The claim was for \$11,500 alleged to be actually spent by the Government for educating the first defendant. At the time of the contract being entered into the first defendant was an infant and the defence was essentially that the contract entered into by the first defendant was void and that consequently the second and third defendants were not liable. Alternatively it was pleaded that as the first defendant had served the Government for three years ten months out of the contractual period of five years, the claim for \$11,500 was excessive and not reasonable compensation. The statement of claim was amended at the hearing to include an alternative claim for the repayment of the sum claimed as having been expended on the infant for necessities. The High Court held that the contract entered into by the first defendant was void as he was an infant at the relevant time. In this case, Chang Min Tat J stated that —if an infant is totally incompetent and incapable of entering into a contract, there is no contract on which he can be sued. (at p. 213).

In another case, *Leha bte Jusoh v Awang Johari bin Hashim* [1978] 1 MLJ 202, the respondent had alleged that he had entered into an agreement for the purchase of certain lands belonging to an estate of which the appellant was the administratrix. At the time of the alleged agreement the

respondent was a minor. It was decided by the learned trial judge held that the purchase agreement was void but since the purchase price had been paid in full and that the respondent let into possession, a constructive trust had been created and the deceased held the lands in trust for the respondent. The appellant appealed. The Federal Court in this case held that the appeal should be allowed on the ground that to import a constructive trust in this case and grant a declaration that the appellant as administratrix held the lands as trustee for the respondent and that the respondent was entitled to possession of the lands was in effect to enforce an agreement which was void ab initio. Ong Hock Sim FJ highlighted that "the appellant, while disclaiming knowledge of it, contends that as it is admitted that the respondent at the date of the agreement, was incompetent to contract, having been born on March 31, 1937, it is null and void, and no specific performance based thereon can be decreed." (at p. 203).

All of the above cases namely *Tan Hee Juan v The Boon Keat*, *Government of Malaysia v Gurcharan Singh* and *Leha bte Jusoh v Awang Johari bin Hashim* reflect that from the judicial point of view, all contracts entered into by an infant is generally void and an infant cannot sue or be sued under such void contracts, even if the Act 136 does not expressly stipulate the effect of an agreement entered into by infants. This is in view of the effect of sections 10 and 11 of the Act 136 which clearly render such agreements void.

Although all contracts entered into by infants, including a contract for necessities are void, section 69 of the Act 136 allows a person who has supplied necessities to the infants to receive reimbursement from the property of the infants. As highlighted by Alsagoff, S.A. (2003), since the word 'necessaries' is nowhere defined in any statutes in Malaysia, the court has to define the terms based on several common law cases. In *Government of Malaysia v Gurcharan Singh* [1971] 1 MLJ 211, Chang Min Tat J, after looking into several common law cases and definitions, he concluded that the term 'necessaries' is given its meaning based on the respective peculiar facts, and the circumstances of the infant's life and needs. Therefore, whether a thing which is provided to infants is 'necessaries' or not would depend on how the thing suited the infant's needs, and it constitutes a question of fact and law and the fact must be founded on the evidence adduced. Although in the above case, it was decided that an infant is totally incompetent to enter into a contract, thus no contractual liability arose on the part of the infant, another legislature was later on passed namely the Act 329 (the Contracts (Amendment) Act 1976) which provides that a scholarship agreement entered into by a minor is valid.

It is clear from the above discussion that based on the decided case laws, all contracts entered by infants are void in view of lack of competency on the part of infants to enter into such contract. Subsequently, the infants shall not be liable under the said contract.

There are however exceptions where contracts entered by infant can be valid, binding and enforceable. The first exception is the one earlier discussed above namely contracts relating to scholarship and education which is specifically deliberated under the Act 329. Other exceptions include limited employment contracts which are governed under the Act 350 (The Children and Young Persons (Employment) Act 1966) as well as marriage contracts which can be seen in the Act 21 (Cheong, 2010). Other exception would be contract of insurance which is governed under the Act 758 (the Financial Services Act 2013).

Based on the above investigations, if the strict application on the rule of competency in Malaysia which is based on all the statutory provisions and judicial decisions above are applied, it can be said that the infants' rights to enjoy benefits of shareholding in a company is no longer a matter worth to be discussed, because it will definitely become void as it does not fall within 'necessaries' for them nor does it fall within any of the exceptions provided in the abovementioned statutes.

Sustaining Family Business through Living Trust

Nevertheless, if one's main concern is to protect and preserve the shares or assets of the family and to ensure that the dividends or income derived from the assets will be enjoyed through many generations without touching the initial capital, then it is definitely appealing to explore alternatives to enable infants to have stake in family business shareholding (Phoon, 2012).

The Concept

The common thought and contemplation to involve infants in family business stake is that the infants may not be capable of running the business because they are just infants who are too young or do not have the competency, skills and knowledge to diligently manage neither their own shares nor the business of the company. In order to address this issue, living trusts may be the answer. Assets such as company shares which form part of a trust are not subject to the estate administration process upon the demise of the owner. Furthermore, the concept of living trust has been examined to be the most suitable device to manage wealth in Islam (Halim, 2012).

The trust is basically created for the purpose of a transition period before the infants become capable and ready to take over the business and the shares. It can be placed under the care of professional management as trustee when the infants are still incapable of handling the business on their own. This is in line with the objective of the said trust which aims to protect and preserve the family business over a period of time. As an illustration, a husband and his wife have an infant child and both of them own all of the shares in their family business corporation. They were found dead due to an accident and the business was eventually wound up over years living nothing to the young infant. If both of them had set up a living trust favouring their infant to hold their company shares while alive, the shares will not be frozen and can be administered by the trustee in accordance with their wishes thus avoiding the disastrous ending. Living trust created for such a purpose is typically known as family business trust. Further, it can also be created to preserve the shares for the collective interest of heirs for over multiple generations.

In this respect, the appointed trustee is required by the law of trust to act in the best interest of the infant beneficiaries. Instead of receiving the shares by the infants directly, the settlor may alternatively nominate a team of persons or professional manager who are capable to function as caretaker of the business before the young infants become capable enough to take over and manage the business on their own. In addition, it is also possible for the shares to be held on trust by the trustee for a period of eighty years which is long enough to span multiple generations and this is more towards achieving long term objectives. The extent of fixed period of 80 years is possible by virtue of Section 17 (b) of the Act 67 (the Civil Law Act 1956) and can be a good option, instead of just restricting it not to exceed the life of one person(s) living when trust is created and 21 years (Halsbury, n.d.).

As can be seen from the above, the living trust basically allows for an orderly and properly succession of business and stakes in the family company so that the younger generation who are still infants can eventually take over and build the business and avoids family disputes over the shares, disruption of business and forced disposals at knocked down prices. It works to preserve the business and the corporations as legacy in the family for the infants.

Effects of Living Trust on the Infant Shareholders

During the trust period, any dividends generated from the underlying family business may be paid to the infant beneficiaries for the purposes of their education, medical and maintenance expenses. As the shares are held by the trustee with instructions to hold throughout the trust period, beneficiaries may not simply sell the shares to outsiders, thus keeping the shareholding intact within the family. The fact that an infant is named as a beneficiary of a living trust, he or she is entitled to enjoy the financial benefit of the trust which is in the form of dividends over the shares held. This is in line with the statutory duty of the trustee which may be exercised according to the discretion of the trustee, but must always be subjects to the terms of the trust duly created, and this requirement is expressly stipulated under section 9 of the Act 208 (Trustee Act 1949). Further, failure on the part of the trustee to distribute the dividend to the named entitled beneficiaries according to the terms of the trust constitutes a breach of trust.

The second effect of the living trust which needs to be examined is whether or not the living trust protects or secures the shares of the beneficiaries from any claims filed by creditors. The answer to this would depend on the nature of the living trust itself, whether the said trust is revocable or irrevocable in nature. A revocable living trust does not protect the shares from the creditors. This is in view of the nature of the revocable living trust itself which terms can be changed or terminated at any time. Due to these terms, the trust creator or settlor maintains ownership of his assets. Therefore, a creditor could force the owner of a revocable living trust to terminate the trust and surrender the assets. In this respect, the infants are still exposed to possible claims by creditors of the family business. Nevertheless, the trust created reduces the chances for such claims to occur as the family business can still be run and managed accordingly by trustee on behalf of the infants even in the event of death or incapacity of the settlor or the main owner of the business, namely parents or guardians of the infants concerned. Therefore, it leads to continuous generation of profits and incomes out of the business which may be utilized to repay the creditors. This saves the shares from being sold for proceeds towards settlement of debt.

Thirdly is whether or not the living trust mitigates possible family rivalry over the legacy of the family business thus affecting the rights of infants over the shares. The fragmentation of shareholding in the family business often results in a lack of interest on the part of the heirs in taking charge of the business or as often seen in many high profile family feuds in the local scene, disputes arise among family members and escalates to debilitating fights that lead to takeover by outsiders, often at much lower value. The living trust is therefore believed to be a platform to ensure proper administration of shares in the hand of the appointed trustee upon the death of the owner. This will definitely avoid further feud and conflicts among the surviving family members on the rightful persons who should be responsible to continue the legacy of the family business. At the same time, it also avoids the shares from falling into the hands of other family members which may be contrary with the true

intention of the owner of the shares or the settlor. At the same time, the living trust allows their infants to continuously enjoy the financial impact which benefit them from the company business managed by the trustee on their behalf.

There is also issue regarding the ability of an infant to exercise his right to vote in the company. An infant may beneficially enjoy and benefit from shares of a corporation, but it may be improper to allow them to exercise voting or effectively manage his interest through resolutions. There is a potential possibility of putting them in a conflict with other adult shareholders. A corporation functions by majority votes of the shareholders who select directors for the board and make decisions on major actions. In a small corporation like family based corporation, the shares are typically held by a limited number of people, making every vote important. Therefore the terms of the living trust must be clear enough to tackle this issue, for examples, the trust may contains a term to the effect that the infants are not given the right to vote until they attains the age of majority, or there may be suggestion to include a proxy clause in the trust to allow an adult or trustee to vote on behalf of the infant's shares until he comes of age.

CONCLUSION

A holistic and successful succession of a family business takes time and effort to plan but it is definitely worth the effort to sustain family business as legacy for young infants through the benefit of shareholdings in the family company itself. Although the statutory provisions and judicial decisions relating to the legal competency of infants to contractually bound themselves as shareholders in a company reflects very restrictive position as against the infants, the living trust is indeed an alternative platform worth to be explored and considered by the parents and guardians if they really wish and intend to ensure continuity of the business to the next generations and at the same time secure the interests of the family company business and the infants to remain intact. Nevertheless, it is advisable for the parents or the guardian to also seek professional advice in respect of the creation of the trust and the construction of the terms of the trust to ensure they have received full information and make a fair and an informed judgment on the viability of creating the living trust itself. This is in view of certain legal consequences which directly or indirectly affect their infants once shares are placed (although beneficially) in their hands, as duly scrutinized above.

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