Topics 1-3

How to advise someone if they should set up a co:

1) Consider if a co is the best option to begin with:

- Have they considered other options like partnership, sole trader, etc?

2) What are the effects of incorporation?

- By incorporating, it means that XX has set up a co.
- There are three effects of incorporation:
    - The Co is a separate legal entity, meaning that XX's co would enjoy separate legal rights, privileges, duties or liabilities from its members or directors (s 124 Corps Act; *Salomon*).
    - The Co can exist perpetually.
    - Liability of the shareholders of a co is limited.

3) What are the benefits of incorporation?

Note that you should **address specifically the concerns** of the person you advise.

- Some of the benefits of incorporation flow from the co's features as a separate legal entity. One example is that the co's tax rate is lower since it is possible to segregate the co's income and assets from the shareholder's.
    - This is of course of benefit to XX since his / her income is rising as is his / her tax.
- A second benefit is that a co has access to a wider range of security from the bank, for example, it can grant a floating charge to the bank.
    - This is of course of benefit to XX since his / her supplies for his / her business can be used as security (good one to use if the person runs a convenience shop for instance).
- A third benefit is that the co can expand. This would of course depend on whether XX has a proprietary co or a public co.
    - A proprietary co can only be limited to 50 non-employee shareholders (s 113(1) Corps Act).
    - A public co can include more than 50 non-employee shareholders.
- Another benefit that comes with a co is that it can exist forever. In the event XX wishes to transfer his / her business to his / her heirs or sell the co, or if XX does, the business can continue. This is of course unless the co is wound up.
- A benefit that comes with the formation of the co is that it can be liable in tort to its members. Consequently, if XX became injured at work, he/she could sue the co in tort.
- Finally, there is a benefit that flows from limited liability: the co's owners are protected from the claims of the co's creditors. The liability of the shareholders is limited to the amount that they have agreed to pay for their shares.
    - This is subject to qualifications.
    - Applying this to XX's case, it means that XX himself / herself is protected from the claims of his / her co's creditors. His/her liability is limited to the amount he /she has agreed to pay for his/her shares.

4) What are the disadvantages of incorporation?

- To incorporate, XX has to register by filling up Form 201. The process is simple but the registration fee is expensive.

- Co are regulated by ASIC, and hence XX by incorporating a co, is subjecting himself/herself to heavy scrutiny - he/she has to ensure that the co complies with the regulatory requirements and it can be ongoing (ss 123, 144, 147-156 Corps Act).
- There is an organic division of power within the co - the dir manage the co, while the shareholders own it (*Shaw & Sons*; s 198A of Corps Act). If XX is not a dir, he/she would have no control over the management of the co.

5) What is the process of incorporation?

- XX could buy a shelf co from businesses which set a co for this purpose or from a legal or accounting firm.
- Alternatively, XX could incorporate a new co. To do so, XX has to consider whether he/she wants to set up a proprietary co or a public co.
  - Under s 113(1) of the Corps Act, a proprietary co must not have more than 50 non-employee shareholders.
  - Under s 114, the minimum number of shareholders in a co is one.
  - *Note that if it's a one person co, it might be better to set up a proprietary co first, then change it to a public co when it expands*.
  - XX also has to consider how the co will be financed. Under s 113(3), a proprietary co cannot solicit funds from the public.
  - If XX chooses to set up a public co, then he/she should be advised that a public co has more obligations under the Corps Act.
- XX has to register with ASIC using Form 201 and pay the registration fee. Under s 117 of the Corps Act, XX has to give them the following information:
  - type of co;
  - proposed name;
  - details and consent of individuals who are to be members, dir and secretary;
  - details of shares;
  - state or territory.
- On registration, ASIC allots the co an ACN, registers the co and issues it with a certificate of incorporation (s 118(1)).
- **Proposed name**: XX should be advised that under s 147, the name he/she picks for his / her co cannot be identical or unacceptable.
  - He/she can check the ASIC register to ascertain whether the co's name he has chosen is identical to another co.
  - Schedule 6 lists the guidelines for 'unacceptable' names and they include the royal family, the government and Sir Donald Bradman.
  - *Must check the facts at this point if there is a proposed name. If not, say* "Consequently, as long as the name XX picks with the guidelines, it will be acceptable."
  - If XX hasn't proposed a name for the co, then under s 148(1), the co can adopt the ACN as its name.
  - Under s 148(2) of the Corps Act, if XX sets up a proprietary co, it has to have "proprietary" or "pty" in its name. If XX sets up a public co, it has to have "limited" or "ltd" in its name.
- **Details and consent of individuals to be directors**: XX should be advised that if he/she wishes to start a co, the minimum number of dir must be met.
  - For a proprietary co, there has to be one dir (s 201A(1)).