JURD7224: Business Associations

Contents

1. Introduction to Business Associations

OVERVIEW

- What is a company
- Who 'owns' the property?
- Who makes decisions about the property will be used?
- Who gets the benefits of profits?
- Who bears any loses?
- How can ownership of the company be transferred?
- How does the government regulate all of this?

Purposes of Incorporation

What is a Company

- **Corporation:** an organisational structure that facilitates the raising of finance for business activity from those with capital for investment but no interest or capacity for management of the business.
    - A fictional legal person – an entity recognised in law as a person.
    - It can enter into contracts, sue and be sued, own property, employ agents and employees.
    - A vehicle to pool funding.

Benefits of Incorporation

- Corporate group has perpetual existence;
- Corporation can bring suit against others and its own members;
- Can enter into contracts as distinct from the acts of individual members;
- Facilitates continuation of management and transferability of shares;
- Limited liability - distinguishes between group liability and the personal liability of individual members.

Who Owns the Property

- A corporation is a person distinct from its members
- Property of the corporation is distinct from the property of its members
- Property of its member cannot be taken in execution for the debt of the corporation and vice versa.

Who Benefits from the Profits

- **Shareholders:** share in the financial gains of the enterprise without having to participate in its management

Who Bears Any Losses

- **Shareholders:** ultimate risk bearers as their financial claims are postponed to those of creditors in winding up.
- **Creditors:** trade creditors, banks and financial institutions
- **Tortious liability claimants:** involuntary creditors

Transfer of ownership

- By sale of shares or assets of the company

Two main types of capital

- Debt - debentures provide by creditors
- Equity – share capital provided by shareholders; shareholders have the residual claim;
    - Partly-paid share – doesn't need to be paid in full until called for; including when the company is insolvent, and a liquidator is appointed;

When does a Company Come into Being

- Date of registration with ASIC

How are Companies Regulated

Corporations Act 2001 (Cth)

- **Referral powers:** States agreed to refer powers to enable the Commonwealth Parliament to legislate with respect to corporations, corporate regulation and the regulation of financial products and services under the *Constitution* s 51(xxxvii) creating the *Corporations Act 2001* (Cth) and the ASIC Act 2001 which commenced 1 July 2001.
- **Expiration:** The referral of powers is subject to a five-year sunset clause expressed to terminate on 16 July 2006 and extended to 2021.
- **Jurisdiction:**
    - Civil matters under corporations legislation is vested in the Federal Court, Supreme Court and for ancillary corporations matters arising in family proceedings in the Family Court of Australia: ss 1336B-C.
    - For criminal matters, several courts of States and Territories exercising jurisdiction for summary conviction of offenders have equivalent jurisdiction for offences against the corporations legislation: s 1338B(1). For indictable offences, courts of State or Territory have jurisdiction only for offences committed outside Australia or offences, committed, begun or completed in that jurisdiction: s 1338B(8).

Australian Securities and Investments Commission (ASIC)

- ASIC has sole responsibility for the administration and enforcement of corporations law.
- ASIC is only responsible to the Commonwealth Minister and Parliament

DEVELOPMENT OF CORPORATE LAW

History of Corporations

- **Corporations sole** – person's position became a corporate entity around the person; e.g. Archbishop of Canterbury; The Public Trustee; The Crown. NB: The *Corporations Act* does not apply to corporations sole.
- **Corporations aggregate** – people who have come together to act as a group.
- **Charter companies** – e.g. British East India Company, Hudson Bay Company, Virginia Bay Company, South Sea Company (1600s) exploited trade in the South Sea – raised capital in market and then paid off dividends but actually had no assets (no underlying substance) called the 'South Sea Bubble.' In 1720, the Bubble Act was enacted and prevented companies trading as corporations.
- **Partnerships –** association of persons who operate business with a view to profit; not a separate legal entity; major overriding issues that each partner has joint and several liability
- **Joint Stock Company –** a partnership which has been invested with the character of incorporation

CORPORATE LAW IN AUSTRALIA

- Process of incorporation – see Small Business Guide: *Corporations Act* Part 1.5

Structure of Corporate Law in Australia

- Statute: *Corporations Act 2001*
- General law (common law and equity)
- Administrative rules: ASIC; Guidance etc.

Key Statutory Provisions

Requirement for Incorporation

- S 114 At least 1 member
- S 115 When > 20 members

Process of Registration

- Ss 117-8 Application process
- S 119 Coming into existent upon registration
- S 122 Recovery of setting up expenses

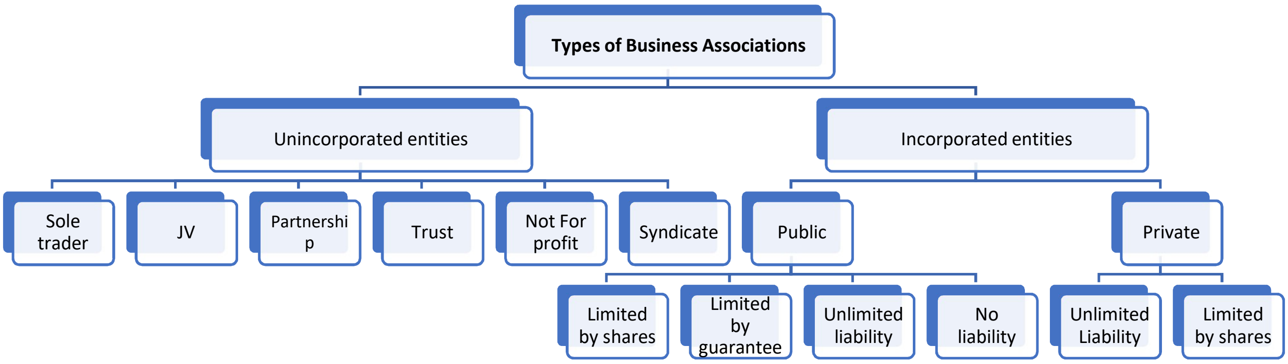
Types of Companies

- S 112 List
- S 9 'Limited company'
- s 112(2) No Liability companies
- s 113 Proprietary companies – registered; cannot conduct public activities;
- s 45A Large and small proprietary companies –
    - Large Pty Ltd companies subject to disclosure requirements
    - Small Pty Ltd company exempt from disclosure reporting requirements
        - $25M
        - Fewer than 50 employees

WHAT IS A BUSINESS?

- **Business:** A course of ***conduct*** undertaken by a person (company or individual or group) for a profit-making purpose
- Company: entity
- **Creditors**
    - Debt holders
    - Raw material providers – accounts payable
    - Customers – warranties, unclaimed gift cards / store credits
    - Employees – unpaid salaries
    - Shareholders – dividend payable
    - Directors – directors fees, reimbursement of expenses
    - Government – tax payable, fines / penalties

- Members of the Public – tortious liability



TYPES OF BUSINESS ASSOCIATIONS

Sole trader	
Sole trader	• **Individual conducting business alone** without benefit of any legal structure or entity status distinct from the individual. • **Sole trader** is responsible for the management and financing of the business. • **Personally liable –** for debts and other liabilities of the business without limitation – including those incurred by employees within scope of authority. • **No formalities** for formation, conduct, transfer or termination of business. • **Tax obligations –** all business income is taxable on an individual basis; few opportunities for tax minimisation.
Unincorporated Associations	
Partnerships and limited partnerships; joint ventures and syndicates	• Private business activities • **Flexible** – no formality required for creation. Internal structure not constrained by statute; no registration or reporting obligations. • **Financing** – partners freely withdraw their capital from the firm which may be dissolved without formality.
Trusts	• **Minimises tax** – trustee separate form beneficiaries. • **No separate legal personality** - Trust is not a distinct legal entity and trustee bears personal responsibility for trust obligations. • **Trust not taxed separately from beneficiaries** – tax advantages.
Unincorporated non-profit associations	• **Clubs** - non-profit goals

	• **Examples** – charitable objects; educational and scientific activities (e.g. schools); sports, social or cultural activities (e.g. football and RSL clubs; the Opera House) • **Professional or trade interests** – law societies, bar associations, retailers associations • **Mutual benefit of members** – credit unions, rural coops, mutual building societies, mutual insurance associations
Corporations	
Co-operatives	• **Limited liability** - may adopt share capital, members only liable for any amount unpaid upon their shares; members without share capital liable to the coop only for charges payable to the coop under its rules.
Incorporated associations	• **Simple and inexpensive** – non-profit associations under the *Associations Incorporations Act 2009* (NSW) • Association of 5 or more persons formed for lawful object to apply for incorporation. • **Fair Trading Commissioner may incorporate** an eligible association whose application is in prescribed form unless satisfied that incorporation could be inappropriate or inconvenient by reason for likely scale or nature of the activities or property nature or extent of dealing with the public: s 7(2) • **Continuing obligations** – appoint public officer (s 34); convene annual general meeting (s 37); tier 1 association audited financial statements complying with AASB (ss 42-45) or tier 2 association true and fair financial statements (ss 46-49) • **Liability** – committee members exposed to personal liability for contracts and torts of the association • **No pecuniary gain for members** – must not conduct its affairs to provide pecuniary gain for members (s 40) • **Surplus property may be vested in another non-profit association** with substantially similar objects upon winding up; must be approved by Commissioner: s 75.
Companies under the *Corporations Act*	• **Formalities** – expensive and ongoing obligations; incorporation is an act of the state; disclosure obligations for benefit of creditors, members and wider community (e.g. financial accounts). • **Procedures** – meetings of members required under Act or company constitution. • **Directors' and officers' duties** – general duties of loyalty and diligence • **Constraints on withdrawal of share capital** from limited companies – protects creditors. • **Taxation** – double taxation as company profits taxable also taxed in the hands of members as distributed dividends.

Choosing Form of Association

- There is wide freedom of choice between the different forms of association.
- Generally, partnerships above a certain size should incorporate to prevent mischief arising from large trading undertakings being carried on by large fluctuating bodies, so that persons dealing with them know who they are contracting with.
- S 115 prohibits formation of more than 20 members of a partnership or associating having its object the acquisition of gain by the association or individual members. Exception – professions specified with ethical rules or regulating statute.
- Limits of members for partnerships: *Corporations Regulations reg* 2A.1.01
    - Medical practitioners – 50 members
    - Legal practitioners – 400 members

    - Accountants – 1000 members.

Factors affecting decision to incorporate

- **Advantages**
    - **Limited liability** – member's other assets insulated from claims against the company and protects against losses.
    - **Duration** - perpetual succession for company
    - **Financing** – companies have greater access to finance, e.g. ability to create floating charge or raise capital through public issue of shares or debt interests (debentures).
- **Disadvantages**
    - **Cost, formality and continuing obligations** – high cost of procedure of incorporation and winding up a company; ongoing compliance obligations (e.g. members meetings; financial reporting).
    - **Taxation** – historically double taxation of companies; but now dividend imputation eliminates double taxation.

Implications for choosing different types of entities

- Impacts on who you sue – e.g. Partners in a partnership
- Clients – what are their obligations, who is the party

TYPES OF COMPANIES

Public vs Private Company

- **Public company:** a company is a public company if it does not come within the definition of a proprietary company: s 9.
    - High standard of regulation: regulation of public companies is important because investors. tend to be further removed from the actual management and control of the company. Regulation establishes minimal standards for corporate behaviour and attempts to ensure shareholders receive adequate and timely disclosure.
- **Proprietary company:** a company that is **<u>registered</u>** as a proprietary company: s 45A(1).
    - Includes company limited by shares or an unlimited company that has share capital: s 112(1).
    - Excludes company limited by guarantee or no liability company: s 112(1).
    - May not have more than 50 non-employee shareholders: ss 113(1) and 601BB(1).
    - Lower standard of regulation: does not need to hold annual general meeting: s 250N.
    - Directors have lower standards for conflict of interest of material personal interest: s 191.
    - Removal of directors does not involve concrete statutory requirements: s 203C (replaceable rule).
- **Single director/shareholder company:** 1 person may form a proprietary company: s 114.
    - Company with only one member may pass resolution by the member recording it and signing the record: s 249B.
    - Director of single-director proprietary company may pass resolution by recording it and signing the record: s 248B(1); may make declaration by recording it and signing the record: s 248B(2).
    - Modification of quorum requirements: s 249B.

Minimum Number of Members

- **One-person company:** a company which one person has de facto control of the company: *Salomon's case*
- All companies must have a minimum of one member: s 114.

Four Main Types

<table>
<tr><th>Type</th><th>Description</th></tr>
<tr><td>Company limited by shares</td><td>A company where liability of its members limited to amount (if any) unpaid on the shares respectively held by them: s 9.
Available to all business companies, rights and obligations of individual members commensurate with the individual's investment.
Member's liability limited to price to be paid for shares – e.g. issued capital was $20,000 where partly paid to 50c, the paid-up capital is $10,000. Remaining liability of shareholders is 50c per share.
Member's liability cannot be increased without consent of member: s 140(2).
Voting rights of members determined by reference to shareholding.</td></tr>
<tr><td>Company limited guarantee</td><td>Limits liability of members to fixed amount of the guarantee.
Members don't contribute while company is a going concern.
Guarantee will only be called in a winding up situation.
If company wound up and company does not have sufficient assets to meet its liabilities, each member obliged to contribute an amount fixed by the company's constitution.
Members liable if they were members within 1 year of the winding up : ss 517 and 521.
Present members must contribute first. Past members only contribute if current members cannot satisfy the guarantee: s 522
Past members need not contribute to liabilities incurred after they ceased to be members: s 520.
Used by non-profit companies.</td></tr>
<tr><td>No liability company</td><td>Available only to mining companies.
Company must have no contractual right under its constitution to recover calls made on its shares from a shareholder who fails to pay them: s 112(2)(c).
Shareholders loss limited to amounts already paid to the company, even when only partly-paid shares.
Must include in its name the words "no liability" or "NL" to warn creditors: s 148(4).</td></tr>
<tr><td>Unlimited liability</td><td>Members liable in winding up for the company's debts without limit on their liability.
Similar to original joint stock companies.
Can reduce its capital at any time without complying with statutory requirements for a reduction of capital: s 258A. Principles of maintenance of share capital for creditor protection do not apply when shareholder liability is unlimited.
Only unlimited liability companies with share capital will be able be registered: s 112(1) and 9
Used by mutual funds – can redeem shares in fund.</td></tr>
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