

BUSINESS ASSOCIATIONS NOTES

Term 1 2020

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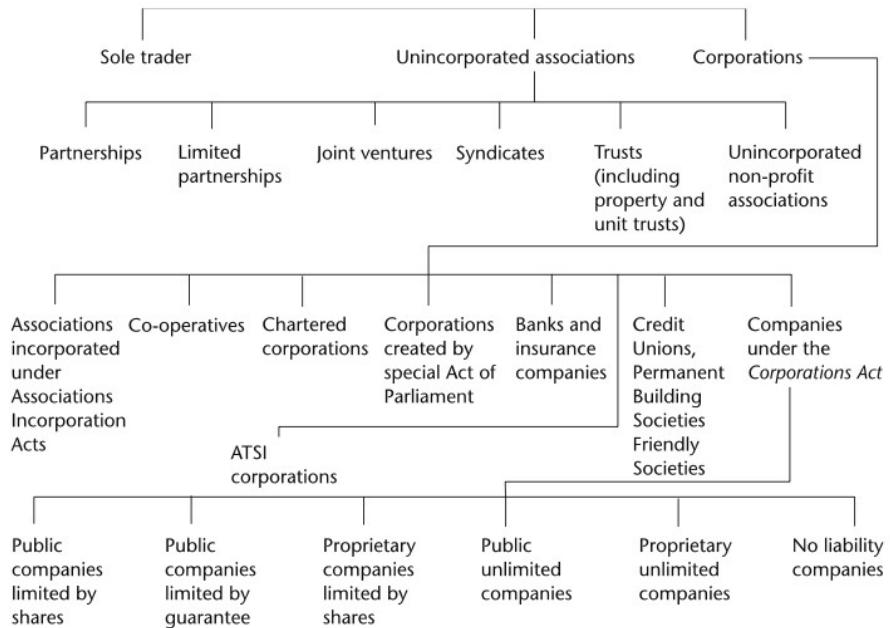
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Week 1B: Forms of Business Association



- The diversity of the forms of association is accompanied by wide freedom of choice between them. The law imposes few fetters upon that freedom. The principal restriction derives from the 1844 Act, that partnerships above a certain size should incorporate, the rationale for the restriction being *"to prevent the mischief arising from large trading undertakings being carried on by large fluctuating bodies, so that persons dealing with them did not know with whom they were contracting, and so might be put to great difficulty and expense, which was a public mischief to be repressed"*.
- The current formulation of this prohibition is contained in the *Corporations Act*, s 115 which prohibits the formation with more than 20 members of a partnership or association having for its object the acquisition of gain by the association or individual members.
 - o An exception is made, however, for a profession or calling of a kind specified since the ethical rules or regulating statute of some professions have traditionally restricted practice in incorporated form. Accordingly, the *Corporations Regulations* (reg 2A.1.01) specify upper size limits for particular partnerships, including
 - medical practitioners (50 members),
 - legal practitioners (400 members) and
 - accountants (1,000 members).

FORMS OF ASSOCIATION

Non-Profits

Much group activity is directed to the pursuit of non-profit goals. The term non-profit covers a spectrum of activities which at one end is closely related to business and profit purposes.

The term may be thought to include:

- activities having charitable objects (eg, philanthropic foundations, associations for political or community purposes);
- educational and scientific activities (eg, private schools);
- activities of a sporting, social or cultural nature (eg, football and RSL clubs, societies concerned with music);
- activities intended to further professional or trade interests (eg, law societies, bar associations and retailers associations); and
- activities carried on for the mutual benefit of members (eg, credit unions, rural co-operatives, mutual building societies, mutual insurance associations).

Private Business

- Private ventures (referring, imprecisely, to those ventures not employing publicly solicited funds) have historically been pursued through the partnership form and, more recently, the limited partnership, joint venture and syndicate.
- However, as we have seen, the registered company form was regularly used from the 19th century as a vehicle for private enterprises.
- Under the Corporations Act, the company limited by shares formed as a proprietary company is a standard form of organisation for small business and is by far the most numerous category of registered company.

Marshalling of Public Funds

- Aggregation of funds on a large scale, for trading or investment within the private sector. The company limited by shares, and necessarily a public company, is the principal form of association for such purposes

Sole Trader

- A sole trader is not involved in business association.
- The term refers to an individual conducting a business alone without the benefit of any legal structure or entity status distinct from that of the individual who conducts it.
- The sole trader is responsible for the management and financing of the business, perhaps with the assistance of one or more employees.
- The trader is personally liable for the debts and other liabilities of the business without any limitation, including those incurred by employees within the scope of their authority.
- There are no formalities accompanying the formation, conduct, transfer or termination of the business unless a business name is used requiring registration or the solvency of the trader is impaired in which latter case the general bankruptcy law applies.

- Taxation legislation imposes obligations of general application including the requirement for an Australian Business Number and returns of income and goods and services tax.
- All income received from the business by the sole trader is taxable on an individual basis and there are only modest opportunities for tax minimisation relative to business conducted in corporate form.
- The general statutory obligations with respect to workers' compensation insurance, government licensing, industrial safety and employment protection apply equally to sole traders as to corporations.

Co-operatives

- Offer limited liability for their members and provide an alternative incorporated form for the pursuit of business as well as for non-profit goals.
- The co-operative is distinguished from the registered company by adherence to certain principles which govern both the formation and conduct of the co-operative and the distribution of surpluses.

Incorporated Associations

- Simple and inexpensive mode of incorporation for non-profit associations
- The fees for incorporation and lodgement of annual statements for all associations are significantly lower than for companies registered under the Corporations Act.
- Perhaps the principal deficiency of the unincorporated association is the exposure of its committee members to personal liability for the contracts and torts of the association.
- Members of the association are not, by reason only of their membership, liable to contribute to the discharge of the association's liabilities (that is, they enjoy what is called limited liability for corporate obligations)
- An association must not conduct its affairs so as to provide pecuniary gain for its members: s 40.
 - o Since incorporated associations are dedicated to non-profit objects, any surplus property on the winding up of the association is not the property of individual members to be distributed among them.
 - o Rather, a distribution of surplus property must be approved by the Commissioner and may be vested in another non-profit association which has substantially similar objects: s 75.

FACTORS AFFECTING THE DECISION TO INCORPORATE

Limited Liability

- A primary motive for incorporating a business is often the desire to limit participants' liability for the obligations of the enterprise
- Incorporation insulates members' other assets from claims against the company and protects against potentially crippling losses which may not always be avoided through insurance.
- Even here, however, incorporation will insulate members from liability to trade creditors and involuntary creditors such as tort claimants

Perpetual Succession

- The company enjoys perpetual succession since it is invested with the legal capacity and powers of an individual with none of the frailties that flesh is heir to.
- In law, the company is an entity distinct from the individuals comprising its membership.
- Its status, therefore, is unaffected by the death or bankruptcy of a member or the transfer of ownership interests

Financing

- Unincorporated forms of business organisation are denied the corporate advantages of the power to create a floating security over its assets (now called a circulating security interest under the *Personal Properties Securities Act 2009* (Cth)) or to make a public issue of its shares or debt interests.
- It is a security interest which “floats” over the subject property (often the whole of the company’s undertaking), allowing the company to deal with and dispose of the property in the ordinary course of business until some defined act of default.
 - o The appeal of this financing instrument, and the sources of finance it may unlock, may be a telling factor in favour of incorporation, although security interests have been devised for unincorporated bodies which approximate its principal advantages.

Cost, formality and continuing obligations

- Partnership is a remarkably flexible business form. No formality is required for its creation. Internal structure is not constrained by statute and no registration or reporting obligations are imposed.
- Partners may freely withdraw their capital from the firm which may be dissolved without formality.
- In contrast, incorporation is an act of the state, attended with formality and expense.
- Corporations Act imposes continuing obligations to disclose information for the benefit of creditors, members and, in some cases, the wider community
- Accounts disclosing the company’s financial position need to be maintained and, for some companies, audited and reported in summary form upon a public register

Taxation

- Historically, the double taxation consequence of incorporation was a disincentive for incorporation. As a distinct legal person, the company’s profits are taxable both in its own hands and in the hands of its members when they were distributed as dividends.
- The dividend imputation provisions introduced in the 1980s eliminate the double taxation of company dividends. Companies which have paid tax on their profits at the company tax rate may pay dividends to shareholders which carry tax credits at this rate.

PROCESS OF INCORPORATION

Obtaining Incorporation

- A company is incorporated by ASIC following an application by a person containing a statement of the matters specified in s 117(2), principally:
 - o the type of company that is proposed to be registered;
 - o its proposed name, unless it is intended that its name will simply be “Australian Company Number” or “ACN” followed by the number assigned by ASIC upon registration;
 - o the names and addresses of persons who consent to be members, directors or secretary of the company (the company need have only one member who may be its only director and secretary: ss 114 and 201F);
 - o its proposed registered office and, if it is different, its proposed principal place of business; and
 - o details of its proposed share capital or guarantee obligation, as applicable.
- If the company chooses to have a company name distinct from its Australian Company Number (ACN) it may reserve the proposed name prior to incorporation: s 152
- A company’s certificate of incorporation is conclusive evidence that all requirements for incorporation have been complied with, and that the company is duly incorporated: s 1274(7A).
- A company registered under the Act or a predecessor statute is referred to in the Act as a “company”: ss 9 (definition), 1378. Generally, the provisions of the Act are expressed to apply to companies. However, in particular contexts, especially those relating to financial market dealings, the Act uses the terms “corporation” and “body corporate” to extend the reach of its provisions to corporations formed under other statutes or sources of power and to unincorporated bodies with some corporate characteristics: s 9 (definition).

Practical Alternatives and Formalities

- The incorporation of a company may take several weeks. A constitution will need to be settled, even if it is not drafted from scratch, the proposed company name reserved and an application for incorporation lodged with ASIC. In consequence, a widespread practice has developed, particularly in small business, of using shelf companies which are incorporated in advance of need, and activated when instructions are received to form a company
 - o The company comes into existence only from registration and derives powers and capacity only upon incorporation: ss 119, 124.