COMPANY, PARTNERSHIP, TRUST OR SOLE TRADER?

QUICK REFERENCE

There are a number of structures which can be used to carry on a business. Each business structure has varying legal requirements and liability limitations. In choosing the most suitable form of business organisation it is important to have an understanding of the characteristics of each business form and to consider its advantages and disadvantages.

Sole traders A sole tradership is the simplest form of business organisation. There is a minimal amount of legislation to comply with compared to other business structures. However, unlimited liability means that the sole trader is personally liable for the debts of the business.

Partnerships Partnership is probably the most common form of business organisation in which a small business is carried on. It combines flexibility and ease of operation with tax advantages.

Limited liability partnerships A limited liability partnership differs from a conventional partnership in that it has two categories of partner ¾ a general partner and a limited partner.

Joint ventures A joint venture is the relationship which exists between parties carrying on a commercial undertaking together for commercial gain. A fine line separates joint ventures from partnerships.

Companies Companies are an often used form of business organisation. They have significant financial and legal advantages, but are also closely regulated and involve a number of formalities.

Associations Associations are not often used as a business entity. They can either be extremely simple or quite complex, depending on whether they are incorporated.

Trusts A trust has significant advantages, particularly when combined with a company. However, trusts are subject to an ancient body of law and can become relatively complex.

Co-operatives Co-operatives are a versatile form of business organisation with some characteristics similar to the company structure.

Business names Generally, a business, whether or not it is a company, must register the name under which it carries on business.

COMPARISON OF BUSINESS STRUCTURES

The following sets out for comparison the important aspects of each of the various forms of business structures discussed in this tab.

SOLE TRADER

* **Nature of the organisation**: it is the simplest form of business organisation.
* **Governing law**: there is less legislation to worry about than with other business organisations.
* **Establishment procedure**: establishment is very simple, involving more practical problems (such as finding a place to work from) than legal considerations.
* **Finance**: the ease of raising capital will generally be determined by the trader's personal credit.
* **Continuity of existence**: the business is tied to the trader and so dies with them.
* **Limitation of liability**: the trader is personally liable for the debts of the business.
* **Control of the organisation**: the trader owns and operates the business and makes all the decisions.
* **Formalities**: administration is simple and costs are low.
* **Admitting new investors or participants**: there is generally no problem in admitting new investors or participants, although certain professional bodies may impose requirements. If an investor or participant is admitted the nature of the business organisation may change.
* **Selling the business interest**: there are few restrictions on the ability to sell, but practical difficulties may arise because a sole tradership is so closely tied to the owner.
* **Cessation of business**: it is generally simple to cease to carry on a sole tradership and the profits and assets of the business remain with the trader.
* **Tax implications**: there are both positive and negative implications. On one side tax losses may be offset against the trader's other income. On the other profits from the business will be taxed at the sole trader's marginal income tax rate which may be higher than the business tax rate.

PARTNERSHIP

* **Nature of the organisation**: it is a relatively simple and flexible form of business organisation.
* **Governing law**: partnerships are governed by statute law, common law and private agreement (the partnership agreement). However, they are less stringently regulated than companies or trusts.

* **Establishment procedure**: establishment is relatively simple and inexpensive. The most important consideration is the partnership agreement.
* **Finance**: finance may be easier to raise than in the case of a sole trader, because it will not be dependent on a single person's credit.
* **Continuity of existence**: the partnership has no existence in law separate from the partners. However, the partnership's existence is not usually tied to the involvement of any one particular person.
* **Limitation of liability**: each partner is personally liable, without limit, for the debts of the firm.
* **Control of the organisation**: the partners own and operate the business and make all the decisions. However, decisions must be made jointly by the partners and some decisions require unanimity.
* **Formalities**: administration is relatively simple and costs are low, there are no necessary formalities involved in establishing a partnership.
* **Admitting new investors or participants**: there is an absolute limit on the size of most partnerships. With some exceptions (such as lawyers and accountants) a partnership cannot have more than 20 partners. Also some professions (such as lawyers and doctors) specify that a qualified person cannot enter into a partnership with an unqualified person.
* **Selling the business interest**: it is not as easy to transfer an interest in a partnership as to transfer shares in a company. There is little market for the transfer of shares in a partnership beyond, say, advertisements in solicitors' journals and the like.
* **Cessation of business**: it can be simple or complicated to end a partnership. Dissolution of a partnership can be achieved voluntarily or by court order.
* **Tax implications**: partnerships do not pay tax, partners do. This means that partnership losses can be offset against a partner's other income. Partnerships are often used for income-splitting purposes.

JOINT VENTURE

* **Nature of the organisation**: it is a simple form of business organisation, but does not involve a general or ongoing relationship between the parties.
* **Governing law**: the complexity of the governing law will depend on the nature of the joint venturers and the nature of the business they are involved in.
* **Establishment procedure**: establishment is generally simple, usually only involving the creation of a joint venture agreement.
* **Finance**: the ease of financing a joint venture will depend on the nature of the joint venturers and the extent of their available credit.
* **Continuity of existence**: the existence of a joint venture is usually tied to the business being carried on. If the business ceases then the joint venture has no further reason for existing.

* **Limitation of liability**: members of a joint venture are joint and severally liable for the debts of the venture (unless they have agreed otherwise).
* **Control of the organisation**: the joint venture agreement will usually provide for the control of the venture.
* **Formalities**: no particular formalities are involved, beyond those applying generally to businesses (such as registration under the Business Names Act).
* **Admitting new investors or participants**: a new participant can be admitted without restriction if the existing venturers agree.
* **Selling the business interest**: the ability to sell the business interest will depend on the joint venture agreement.
* **Cessation of business**: termination will usually occur in accordance with the joint venture agreement after a specific time or on completion of a project.
* **Tax implications**: the joint venture is not an individual legal entity and so does not pay tax. The joint venturers will be taxed on the joint venture income as they are on any other income they receive.

COMPANIES

* **Nature of the organisation**: it is a relatively complex form of organisation bound by many rules and regulations. A company has an existence independent of its members and so can sue and be sued and enter into contracts.
* **Governing law**: companies and their activities are directly regulated by the Corporations Law. The Corporations Law controls most aspects of a company's formation, business and winding up and must be carefully considered.
* **Establishment procedure**: the act of establishing a company is called incorporation. The incorporation procedure is more complex and more expensive than for most other forms of business organisation.
* **Finance**: finance in a company can either be raised through borrowing (which the company can do in its own name) or through the sale of shares in the company.
* **Continuity of existence**: companies are legal entities in their own right and do not depend on the continuing existence of members. Therefore, the death, retirement or other withdrawal of a member will not terminate the company and may not even require any reorganisation of the company's operations.
* **Limitation of liability**: the liability of members of a company depends on the precise nature of the company. Generally, a member will be liable only to the extent of the capital he or she has contributed (or promised to contribute) to the company.
* **Control of the organisation**: control of a company generally lies with its board of directors. A shareholding does not give the shareholder any proprietory interest in the assets of the business or any say in the direction of the company. However, a large shareholding may give

control over the board. The precise nature of the control is limited by the Corporations Law and the company's constitution.

* **Formalities**: there are a number of formalities involved in setting up, running and winding up a company. Apart from those formalities applying generally to businesses, companies must also comply with requirements as to meetings, filing of returns and keeping registers.
* **Admitting new investors or participants**: a new participant may be admitted quite simply by buying shares in the company.
* **Selling the business interest**: either the whole business or the business interest of a single member can be sold quite simply.
* Cessation of business: a company can only be terminated in accordance with the Corporations Law.
* **Tax implications**: the company is a separate legal entity and so pays tax. Companies are taxed at a flat rate which is significantly lower than the upper ranges of the marginal tax rates applying to individuals. If the company is to make significant profits there can be a large tax saving. The company is also a useful vehicle in tax planning.

ASSOCIATIONS

* **Nature of the organisation**: an association can be as simple or as complex as the members desire; and incorporated associations will generally be more formal and more complex. An association has no separate legal identity unless incorporated.
* **Governing law**: each State and Territory has legislation regulating the incorporation of associations.
* **Establishment procedure**: the incorporation of an association is similar to, but simpler and cheaper than, incorporating a company under the Corporations Law.
* **Finance**: initially finance will depend largely on the personal credit of members; if the association is incorporated, it can borrow in its own name.
* **Continuity of existence**: an unincorporated association will only continue as long as members are interested. An incorporated association has perpetual succession and so an existence independent of its members.
* **Limitation of liability**: the liability of members of an unincorporated association is limited to the amount of their subscription to the association, however in some circumstances the committee members can be held liable. In an incorporated association all members' liability is limited.
* **Control of the organisation**: an association is normally controlled by a committee acting in accordance with the rules of the association.
* **Formalities**: there are few formalities for an unincorporated association. The formalities relating to an incorporated association vary from jurisdiction to jurisdiction but generally relate to reporting on the association's finances.

* **Admitting new investors or participants**: this will depend on the rules of the association.
* **Selling the business interest**: this will depend on the rules of the association, but will be far more difficult in the case of an unincorporated association.
* **Cessation of business**: the ease or difficulty involved in winding up an association will depend entirely on the nature of the association in question.
* **Tax implications**: the members of an unincorporated association will be taxed as any other individual. An incorporated association may be liable to tax in some circumstances, but this is unlikely to affect its members as any profits made by the association cannot be distributed.

TRUSTS

* **Nature of the organisation**: the trust is a complex form of business organisation. There are a number of various forms a trust may take.
* **Governing law**: each jurisdiction has a Trustee Act, but much of the law relating to trusts is common law and equity.
* **Establishment procedure**: establishment is not necessarily complex but is technical.
* **Finance**: finance will depend solely on the particular circumstances.
* **Continuity of existence**: the trust does not have an independent existence, so the death of an individual beneficiary or trustee may not be a serious problem. If the trust has no property to administer then there is little need for the trust to continue.
* **Limitation of liability**: a trustee is usually liable for actions taken and debts incurred as trustee. A creditor's right to recover his or her debt from the trust property itself is limited.
* **Control of the organisation**: the trustee has control over the trust but must fulfil his, her or its fiduciary relationship to the beneficiaries. Beneficiaries have only limited rights to influence the trustee's discretion.
* **Formalities**: a trust generally involves fewer formalities than running a company.
* **Admitting new investors or participants**: this will depend on the trust deed and, to an extent, the trustee's discretion.
* **Selling the business interest**: a trustee has the power to sell any trust assets.
* **Cessation of business**: it is a relatively simple matter to wind up a trust, generally it is more of a practical than a legal question.
* **Tax implications**: a trust offers substantial tax advantages because of its flexibility. The business person can use the trust to split his or her income, but retains broad control over the funds.

CO-OPERATIVES

* **Nature of the organisation**: a registered co-operative is a body corporate with a legal personality separate from its members.

* **Governing law**: co-operatives are governed by a specific body of law as well as being subject to general business law.
* **Establishment procedure**: establishment is not necessarily complex, but the Registrar has a discretion whether to allow registration or not.
* **Finance**: the availability of finance will depend solely on the particular circumstances.
* **Continuity of existence**: the co-operative has an existence independent of its members.
* **Limitation of liability**: members' liability is limited by the amount of share capital they subscribe for, and the rules of the co-operative.
* **Control of the organisation**: the organisation is ultimately controlled by members but its business is controlled by a board of directors (like a company).
* **Formalities**: there are certain formalities involved in the co-operative form of organisation but these are not unduly onerous.
* **Admitting new investors or participants**: shares can be bought with few restrictions.
* **Selling the business interest**: shares can be sold with few restrictions beyond possible practical problems.
* **Cessation of business**: a co-operative can be wound up or can be taken over by another.
* **Tax implications**: there are particular tax laws relating to co-operatives, one advantage of which is that a co-operative will pay tax on any trading surplus at company rates.

ADVANTAGES AND DISADVANTAGES OF MAIN STRUCTURES

Set out below are some of the advantages and disadvantages of the main business structures: sole trader, partnership and corporation.

Sole trader

The main advantages of starting or acquiring a business through a sole tradership are:

- It is the simplest form of vehicle, with the least legal and administrative procedures and costs of implementation.
- The proprietor has full control of the business.
- The proprietor is entitled to the entire profits of the business.
- The proprietor is entitled to sell or to discontinue the business.
- Discontinuance of the business requires minimum legal cost.

Some disadvantages are:

- The proprietor has unlimited personal liability for debts and for negligence (eg employees' errors) committed while conducting the business.

- Success and continuance of the business are tied to the ability and health of the proprietor.
- Management skill is confined to that of the proprietor and the employees.
- Expansion and raising additional capital is more difficult than when more sophisticated vehicles are used.
- It is unsuitable when more than one person is involved in providing capital for and in conducting the business and each desires to share in control and management of the business.

If this vehicle is suitable for a particular client and business acquisition, some of its major disadvantages can be ameliorated. For example, many risks of loss (including for negligence) can be protected by insurance. Some assets can be removed from the reach of creditors, eg by leasing instead of owning them. People wanting to conduct their businesses on their own can also form a proprietary company.

Partnership

Some advantages of the partnership are:

- The legal and administrative procedures and costs of formation are relatively inexpensive.
- A partnership provides for the business the combined labour, expertise, management skills and financial resources of the partners.
- There is greater ability to overcome the consequences of the disability, sickness or accident of a partner than for a single proprietor.

Some disadvantages are:

- The unlimited liability of each partner for debts and the conduct of the business, including for the activities of each partner.
- The potential for disputes and breakdown in the mutual trust of the partners.
- More potential for raising further capital than sole proprietor, but less than corporate proprietor.
- Potential problems relating to the retirement or admission of partners.
- There is the potential for termination in the event of disputes and there may be considerable legal and other costs in the event of a disputed dissolution of the partnership.
- A partnership is not a separate legal entity for most purposes and requires the participation of all partners for many legal transactions.

Corporation

Some advantages of a corporation are:

- Corporations have perpetual succession (until wound up or dissolved) and their continuance is not affected by the death or withdrawal of shareholders.
- Shareholders generally have limited liability and are not liable for the debts of the corporation.
- The corporate structure affords considerable flexibility in the organisation, management and financing of the corporation, because:
    (a) corporations may have a large number of shareholders while partnerships are restricted to 20 partners;
    (b) shareholders may have varying entitlements to dividend and control;
    (c) corporations may be private or public and large corporations may be listed on the stock exchange;
    (d) it is possible to seek funds from the public, subject to compliance with statutory requirements;
    (e) it is easier to finance larger business projects through the corporate structure; and
    (f) proprietary companies can be formed by only one person, making them a suitable corporate structure for the sole trader or for some subsidiary companies.
- Ownership and management of corporations can be separated and control can be vested in directors and in some groups of shareholders.
- Shares can be bought and sold without interfering with the corporate structure.
- There is considerable scope for tax planning.

However, there are some disadvantages of utilising the corporate structure, particularly when the business is relatively small and unsophisticated:

- The corporate structure is more expensive and complex to form and to maintain in existence in terms of legal and accountancy work and administration.
- There are more detailed and rigorous legal and financial reporting requirements than for partnerships or for a sole trader although proprietary companies, especially those that are ``small'', have fewer requirements to meet than other companies.
- As some of the corporation's financial information must be filed in publicly available registers, there is less privacy regarding its financial affairs than for partnerships.
- Shareholders, particularly minority interests, may not have very effective involvement or control over decision-making or management.