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Instructor manual

to accompany

Company law: an interactive approach

2nd edition

by

Chapple et al.

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Retrofit case study

How to teach with this case

Students are expected to treat the case study as a real-world business scenario, and Julian Harris and his Retrofit business as real clients. The case study does not provide all the information needed for each decision. Students need to develop the skills to know what might not have been said or provided, and to ask their clients the right questions. It is important to regularly remind students that they will need to ask their client questions. They cannot rely on the client to know exactly what information to provide.

Students should understand that it is their job as an adviser to:

- LISTEN to their client
- UNDERSTAND the law in relation to their client's questions
- SEEK further information.

Students need to understand what is important to the client and why the client wants things a certain way. An adviser will not always remember all the information about their client and it is therefore important to regularly review and reacquaint themselves with the client as the case study develops.

The first appearance of the Retrofit case in each chapter presents relevant background information, events that have occurred since the previous chapter, and an overview of the issues that will be raised in the current chapter. The list of issues at the end of the first case box in the chapter includes the key considerations/questions to be analysed in order to advise Julian. By working through the chapter and, in particular the Retrofit Activities and Insights that appear in most of the learning objective sections of the chapter, the student should be able to formulate a response to each of these issues. The more specific questions that are sometimes included are intended to help students focus on the key information relevant to decisions.

Chapter 1: Business organisations

Students should watch part 1 of the case study and/or read the case study in the printed text.

Issues

- What options does Julian have to structure the Retrofit business?
- Julian still wants to run the business — *he wants to be in control*. How would other business structures differ from just Julian as a sole trader?
- Is Bev correct to suggest that Julian should set up a company to run the business? Why? What are the advantages and disadvantages of the different types of business structure?

At this stage, before studying the chapter, the student will not necessarily be able to advise a client on these questions, but should be able to think about the issues in more general terms:

- Students should name and describe the basic characteristics of each of the common business structures used in Australia.
- Students should be able to identify the most important considerations for Julian based on the information given in the case. They should then assess the extent to which the sole proprietorship business structure fulfils his requirements now and into the future. Students might be able to assess how some other structures would meet Julian's requirements. Alternatively, students should at least recognise that other structures have different characteristics and need to be considered against Julian's requirements.
- Students should recognise the different legal status of the different business structures, along with the basic characteristics of each structure relating to ownership, liability and control.
- Students should discuss the pros and cons of each different business structure generally and specifically in relation to Julian's business, goals and circumstances. The focus of this text is the company structure and as such emphasis is given to the characteristics of the company structure. Students should discuss the relative advantages and disadvantages of each company for Julian's circumstances. Students might reach a conclusion as to the structure(s) they feel best suit Julian and should be able to justify their recommendation(s).

Learning objective 1.1: Define the key business structures used in Australia and list some of the factors to consider when choosing an appropriate structure.

What factors are relevant to Julian's decision? Which structures are appropriate?

Students need to consider which issues are important for Julian. Julian has indicated he wants to keep control of Retrofit. He is also apparently aware of the issues of risk given he transferred assets to his wife Samantha.

Asset protection and control are Julian's two key drivers. The most appropriate structure is the one that meets these objectives.

- What options are there?
- Discuss a partnership; for example, involving Julian, employee Tom and Pauline.
- Discuss the use of a trust. What type — a discretionary or fixed unit trust?
- Discuss a superannuation fund, retirement planning and succession plan for the business. (Requires some knowledge of superannuation and SIS rules.)
- Is Bev correct to suggest setting up a company to run the business? Students should explain the main concept of forming a company: separate legal identity. Prove by looking at the issues above that Bev is correct.
- Students should recognise that whatever structure is created for Julian, it may not be the final structure.
- What are the advantages and disadvantages of each structure? Suggest that as an exercise, ask students to compile a spreadsheet of advantages and disadvantages (e.g. see the tables in chapter 1). Relate the advantages and disadvantages back to the case study and the nature of the activity. Do not talk in isolation of the advantages and disadvantages.
- How is a company different from an individual — Julian still wants to be in control and run the business.

Learning objective 1.2: Outline the sole trader structure.

Assess the suitability of a sole trader structure for Julian's business.

Assessing the appropriateness of the sole trader structure for Julian requires the student to understand what options Julian has:

- stay as he is
- form a partnership
- form a trust (What type?)
- form a company (What type?).

The first issue to be examined is the nature of the business or activity that the new entity (if appropriate) will be undertaking. Will it be a business (debtors, creditors, trading stock, assets etc.) or an investment (passive) activity? The reason for this is one type of activity may expose Julian to more risk than the other.

Key factors students need to consider or discuss are:

- What is important to Julian? If it is control, does he retain it via the existing structure or will a new one help?
- How will expenses be affected? Will there be lower costs, especially tax? This requires the student to understand the difference between marginal and average tax rates and how other structures are taxed and the taxation treatment of different types of income. Students can use the data from the case to run a scenario for each type of entity. It is important to remind students to not ignore the other subjects they have studied or will study.
- Succession planning. How easy will the business be to pass on to Pauline or other family members?
- Risk minimisation. Is the type of business currently or under a new structure high risk (commercial) or low risk (investment)?
- How can the business raise funds? How easy will it be to access funds?

Learning objective 1.3: Outline the partnership structure.

Assess the suitability of a partnership for Julian's business.

Similar to the sole trader scenario, a significant feature of the partnership is that it also has unlimited liability for business debts.

Key factors students need to consider or discuss are:

- What is important to Julian? If it is control, then in a partnership, he must relinquish control. The default rule is that all partners have the same rights to manage.
- How will expenses be affected? Will there be lower costs, especially tax? Individual partners are taxed on their income, and the partnership is accountable to the tax office to lodge partnership accounts. This requires the student to understand the difference between marginal and average tax rates and how other structures are taxed and the taxation treatment of different types of income. Students can use the data from the case to run a scenario for each type of entity. It is important to remind students to not ignore the other subjects they have studied or will study.
- Succession planning. How easy will the business be to pass on to new partners?
- Risk minimisation. Is the type of business currently or under a new structure high risk (commercial) or low risk (investment)? The default rule is that all partners are equally (jointly and severally) liable for the business debts.
- In choosing new partners, what do they bring to the business — capital or expertise? What share in the profits will they expect?
- How can the business raise funds? How easy will it be to access funds?
- Julian needs to consider that a formal partnership agreement will be required. It would appear that the default rules in the partnership legislation may not suit his expectations. Suggest that students locate a precedent partnership agreement.

Learning objective 1.4: Describe the characteristics of a joint venture.

Assess the suitability of a joint venture for Julian's business.

Similar to the partnership scenario, a significant feature of the joint venture is about shared control.

Key factors students need to consider or discuss are:

- What is important to Julian? If it is control, then in a joint venture the parties (joint venturers) must agree on who manages the venture — often this is a separately created management entity (sometimes referred to as the joint venture vehicle).
- A joint venture is a matter of contract, so there must be a specific joint venture agreement. There are very few 'default rules' that apply to joint ventures; for example, there is no specific legislation such as applies to other legal structures.
- How will expenses be affected? Will there be lower costs, especially tax? Individual joint venturers are taxed on their income, and the joint venture might still be accountable to the tax office to lodge venture accounts. This requires the student to understand the difference between marginal and average tax rates and how other structures are taxed and the taxation treatment of different types of income. Students can use the data from the case to run a scenario for each type of entity. It is important to remind students to not ignore the other subjects they have studied or will study.
- Succession planning. How easy will it be to terminate?
- Risk minimisation. Is the type of business currently or under a new structure high risk (commercial) or low risk (investment)? Who bears the risk for what, who pays which expenses and how the output (e.g. profit, product) is shared if the venture is successful all need to be specified in the joint venture agreement. Joint venturers have to be careful to structure their agreement so that it does not operate like a partnership.
- In choosing a joint venturers, what do they bring to the venture that Julian does not have — capital or expertise? What share in the profits will they expect?
- Each party to the joint venture must exist as a separate entity in their own rights — does Julian come to the venture as a sole trader?
- Joint ventures can be useful in small business for different venturers to offer ancillary or related goods and services to customers from the same location.
- Julian needs to consider that a formal joint venture agreement will be required. Suggest that students locate a precedent joint venture agreement.

Learning objective 1.5: Outline the trust structure.

Assess the suitability of a trust for Julian's business.

A significant feature of a business trust is the separation of the ownership of the assets from the beneficiaries.

Key factors students need to consider or discuss are:

- What is important to Julian? If it is control, then in a trust the trustee owns the assets and makes the decisions. Does Julian consider himself to be the trustee? Usually a company is registered to become the trustee.
- A trust is a matter of contract, so there must be a formal trust deed. A trust requires the settlor to establish the trust, the trustee to own the assets and make decisions, and beneficiaries who receive the surplus income generated from utilising the assets. Who does Julian see will perform these roles?
- How will expenses be affected? Will there be lower costs, especially tax? Individual beneficiaries are taxed on their income when it is distributed by the trustee. This requires the student to understand the difference between marginal and average tax rates and how other structures are taxed and the taxation treatment of different types of income. Students can use the data from the case to run a scenario for each type of entity. It is important to remind students to not ignore the other subjects they have studied or will study.
- Succession planning. How easy will it be to terminate? What of the trustee needs to be replaced? What if new beneficiaries need to be added?
- Risk minimisation. Is the type of business currently or under a new structure high risk (commercial) or low risk (investment)? The trustee bears all the risk.
- Depending on the type of trust (fixed, discretionary), what expectations do the beneficiaries have to receive a distribution from the trust?
- Julian needs to consider that a formal trust deed will be required. In addition, there are some default rules governing the duties and responsibilities of trustees in trusts legislation in each state. Suggest that students locate a precedent trust deed.

Learning objective 1.6: Outline the company structure.

Assess the suitability of a company for Julian's business.

A significant feature of a company is the separate legal entity principle, so once Julian registers a company, he has created an entity that is separate in law from the people/entities who go on to own it and manage it. This has significant advantages for small business owners, but it also involves significant formality to establish and ongoing compliance.

Key factors students need to consider or discuss are:

- What is important to Julian? If it is control, then a company makes decisions through the owners and managers. Julian will need to control both.
- A company requires registration through ASIC. It needs a promoter to undertake this role. It needs at least one director and one member to register. Who does Julian see will perform these roles?
- How will expenses be affected? Will there be lower costs, especially tax? A company is taxed as a separate entity. Any income that its shareholders receive by way of dividend, is taxed as their individual income (although Australia has a dividend imputation scheme to minimise the economic impact of double taxation). This requires the student to understand the difference between marginal and average tax rates and how other structures are taxed and the taxation treatment of different types of income. Students can use the data from the case to run a scenario for each type of entity. It is important to remind students to not ignore the other subjects they have studied or will study.
- Succession planning. How easy will it be to terminate a company? What if the identity of owners and managers change?
- Risk minimisation. Is the type of business currently or under a new structure high risk (commercial) or low risk (investment)? The company bears all the risk, as it is liable for its own debts.
- Depending on the type of company, there are different rules for limited liability. What type of company should Julian consider?
- Julian needs to consider that a formal application for registration will be required. In addition, there are some default rules governing the internal governance of companies (replaceable rules) in the legislation. Should Julian's company rely on these or customise them? Suggest that students locate a Form 201 required for registration.

Should Julian stay a sole trader or choose one of the other business structures?

If students have systematically worked through the activities for the prior learning objectives, then they are well placed to make an informed recommendation of the options open to Julian. Julian has several issues that are important to him, but in changing the business structure emphasise that there will be some compromise.

Learning objective 1.10: Outline business name registration requirements.

What implications does the business structure have for Julian's use of a business name?

Discuss the meaning of a business name and how business names are regulated under the relevant legislation. The legislation applies to all types of entities.

APPLIED PROBLEMS

1.11 Alf is a recently retrenched corporate manager who decides to form a lawnmowing business in his local area to help him keep fit and earn a little income (no more than \$30 000 per year). He already owns a large four-wheel drive car, and plans to buy a large trailer, two lawnmowers and whipper-snipper.

- (a) Alf approaches you for advice about an appropriate legal structure for his new business. Advise Alf, specifying explicitly any assumptions you consider necessary.**
- (b) Alf discusses his business idea with Ben and Carrie, who were also recently retrenched, and they agree to enter into business together. Each has distinct skills and experience to bring to the start-up, and they are based in different geographical regions. What advice would you provide?**

Answer:

(a) Currently, Alf is a sole trader (or sole proprietor), that is, is a person who trades alone in their own right and who bears sole responsibility for their business. A sole trader receives all the profits from the business, but they must also bear all of the losses. A sole trader has **unlimited liability** — they are personally responsible for the debts of the business and if they are either unwilling or unable to meet the business's liabilities, they can be made bankrupt.

A sole trader is still able to utilise a company structure, as in Australia, companies only need 1 member to register.

Company: As a separate legal entity, a company has the powers of an individual and it can therefore enter into contracts, sue and be sued in its own name. Furthermore, the owners of most companies have only limited liability for the company's debts. Another advantage of the corporate form is that a company has an indefinite life. Once registered a company will exist until it is deregistered. Compared with other business structures, the owners of a company can easily transfer their ownership interest by selling their shares in the company to other investors.

Alf should consider some of the following factors as to whether to stay a sole trader or incorporate the business:

- What activities will the business undertake?
- How much will it cost to set up?
- How can funds be raised to grow the business?
- What are the ongoing costs to comply with regulatory obligations?
- What records will the business need to keep?
- What disclosures will the business need to make to the regulators?
- What are the tax advantages and disadvantages?
- Can personal and business assets be protected?

- What personal legal liability will the owners and managers have?
- Does the type of business or industry affect the business structure?
- How do changes in ownership of the business work?
- Does the structure allow for succession planning?

(b) Partnership: A possibility when individuals join forces with other individuals in business is to form a partnership, in which all partners share control. A **partnership** is a relationship or association between two or more entities, carrying on a business in common with a view to making a profit. Each partner in a partnership is personally liable for all the debts of the partnership, even if they are caused by decisions or acts by other partners.

A group of individuals should also consider a company structure.

Company: As a separate legal entity, a company has the powers of an individual and it can therefore enter into contracts, sue and be sued in its own name. Furthermore, the owners of most companies have only limited liability for the company's debts. Another advantage of the corporate form is that a company has an indefinite life. Once registered a company will exist until it is deregistered. Compared with other business structures, the owners of a company can easily transfer their ownership interest by selling their shares in the company to other investors.

Each of Alf, Ben and Carrie need to consider how the factors affect them individually and collectively, to decide whether to incorporate:

- What activities will the business undertake?
- How much will it cost to set up?
- How can funds be raised to grow the business?
- What are the ongoing costs to comply with regulatory obligations?
- What records will the business need to keep?
- What disclosures will the business need to make to the regulators?
- What are the tax advantages and disadvantages?
- Can personal and business assets be protected?
- What personal legal liability will the owners and managers have?
- Does the type of business or industry affect the business structure?
- How do changes in ownership of the business work?
- Does the structure allow for succession planning?

[LO 1.1, 1.2]

1.12 Mei, Jun Kai, Alek, Ida and Caroline are the newly elected management committee members of a kindergarten for their children, which is structured as an unincorporated association. In their first management committee meeting, the director of the kindergarten advises that at the end of last month one of the grandparents, who had a known heart condition, tripped on a broken concrete path at the entrance to the main kindergarten building, splitting his head open and requiring stitches. The committee members inquire whether there is any risk of personal injury litigation, and the director confirms there may well be, as this is the second time someone has tripped on the path.

- (a) What is the liability of the committee members?**
- (b) Why?**
- (c) What advice would you provide regarding the legal structure of the organisation?**

Answer:

- (a) The kindergarten operates as an unincorporated association and as such has no legal standing. In the circumstances, the claimants would bring their action against the individual members.
- (b) As an unincorporated association is not a legal entity separate from its members. This means that its members can sue, and be sued in their own names. In some circumstances, the court would rule that the management committee is carrying out the operations and are personally liable: *Bradley Egg Farm Ltd v Clifford*.
- (c) To avoid individual members running the risk of being liable an incorporated association could have been formed to conduct the affairs of the club. [LO 1.8]

1.13 Twenty information technology specialist programmers get together to provide an open-source, non-profit quality online encyclopedia which can be used as a reference tool, like Wikipedia, for the common good of members, who may be students or non-students. Pages in the encyclopedia will be edited by members, who will pay \$5.00 per year to subscribe to the group. None of the members feel that incorporation is warranted at this stage.

- (a) What type of legal structure is the group?**
- (b) At what point, and in which circumstances, might it be necessary for the group to incorporate?**

Answer:

(a) Currently, the group has no legal structure and operates as an unincorporated association and as such has no legal standing. When individuals join forces with other individuals for a not for profit purpose, it cannot be a partnership, as a partnership requires a business and an intention to share profits. Individual members running the risk of being personally liable in an unincorporated association.

(b) To avoid uncertainty as to the legal structure, an incorporated association could be formed to conduct the not for profit operations. The group should consider three possibilities:

Company: As a separate legal entity, a company has the powers of an individual and it can therefore enter into contracts, sue and be sued in its own name. Furthermore, the owners of most companies have only limited liability for the company's debts. Another advantage of the corporate form is that a company has an indefinite life. Once registered a company will exist until it is deregistered.

Companies limited by guarantee — a company limited by guarantee involves the members of the company undertaking to contribute specific amounts to the company in the event the company is wound up. This structure is often used for clubs and charities.

Incorporated association: An incorporated association is a separate legal entity registered under the relevant State or Territory legislation and is subject to a degree of regulation. One of the main reasons for a not-for-profit organisation to become an incorporated association is to limit the liability of its members.

Cooperative: Cooperatives range from not-for-profit organisations to substantial commercial trading enterprises. In all cooperatives, members' fees form their initial capital contribution to the business. Each member of a cooperative has an equal share and one vote, and the members can make joint decisions towards the running of the business. Cooperatives are incorporated to provide members with limited liability. Cooperative is a separate legal entity registered under the relevant State or Territory legislation.

Digital cooperatives are typical of the sharing economy. They are cooperative digital platforms or networks that encompass all those cooperatively owned technologies that enable

their constituent communities to create, contribute to and use their online networks. Often little attention is paid to appropriate legal structures at the outset — digital cooperatives seldom set out to become cooperatives in a legal sense, and many digital trading cooperatives are unincorporated. It is only once people recognise the digital technology as having a commercial value that contests for ownership or control, and concerns about the distribution of investment returns and risks, arise.

[LO 1.6, 1.7, 1.8]

- 1.14 Dr Abby is a medical practitioner who earns \$150 000 per year on average. Her husband, Ben, is not employed in the paid workforce, but takes care of their three children, Charlie, Di and Elizabeth, all of whom are under 18 years of age and dependants of Abby and Ben. Abby seeks your advice on how best to structure her practice and affairs to minimise her taxation liabilities and protect her key assets (e.g. the family home) from potential litigants.**

(a) Advise Dr Abby.

Answer:

Trading trusts provide a mechanism for sole traders, for example here a person in professional practice, to structure their business operations. A trust is an equitable device by which one person (the trustee) holds property (the trust property) for the benefit of another person or persons (the beneficiary or beneficiaries).

A trust requires some formality to establish. The **settlor** is the person who ‘creates’ the trust — by settling \$10 or some other nominal sum on the trust. The capital of the trust may be increased or reduced during the life of the trust, provided there is sufficient capital in the trust to cover any capital distributions to beneficiaries. After they have established the trust, the role of the settlor is effectively finished.

The **trustee** is the legal owner of the trust property and has legal authority to administer that property. The trustee has been entrusted to deal with the trust property for the benefit of others. The trustee is subject to fiduciary and statutory duties. For example, the trustee must ensure that the terms of the trust are carried out, that they deal prudently with the trust property, and that they make appropriate distributions to beneficiaries. The **beneficiary** is a person on whose behalf, and for whose benefit, the trust property is held. Beneficiaries have a beneficial interest in the trust property. The amounts that each beneficiary receives by way of income or capital under the trust are determined by the terms of the trust, which are generally set out in the trust deed.

The main reasons for using trusts are for taxation purposes, asset protection, and superannuation.

[LO 1.5]

1.15 Jenna, Koda and Lula decide to start a business baking expensive wedding cakes. Jenna and Koda will each invest \$10 000 in the business. While they don't want to participate in the day-to-day running of the business, they still want to have an active role in management. Lula has no money to invest, but she has years of experience baking cakes.

Lula's son, Asa, also wants to invest \$50 000 in the business. He wants to have a steady income from his investment. While he does not want to be involved in the management of the company, he still wants to have some ability to direct how his \$50 000 investment is spent.

- (a) What legal structure would you advise for their project: a partnership, an incorporated association, a company (if a company, provide details on the type of company) or some other structure?**
- (b) Why would you recommend this structure? Provide details.**

Answer:

(a) Partnership: A possibility when individuals join forces with other individuals in business is to form a partnership, in which all partners share control. A **partnership** is a relationship or association between two or more entities, carrying on a business in common with a view to making a profit. Each partner in a partnership is personally liable for all the debts of the partnership, even if they are caused by decisions or acts by other partners.

Incorporated association: An incorporated association is a separate legal entity and its members have limited liability used for reasons other than business.

Company: A **company** or corporation is a separate legal entity formed under the Corporations Act 2001 (Cth). The company is the most common business structure for organisations in Australia.

As a separate legal entity, a company has the powers of an individual and it can therefore enter into contracts, sue and be sued in its own name. Furthermore, the owners of most companies have only limited liability for the company's debts. Another advantage of the corporate form is that a company has an indefinite life. Once registered a company will exist until it is deregistered. Compared with other business structures, the owners of a company can easily transfer their ownership interest by selling their shares in the company to other investors.

Categorised by liability, companies may be as follows.

- Companies limited by shares — such a company is formed on the basis that the liability of members is limited to any unpaid amount on the shares they hold.

Companies may be proprietary or public.

- Proprietary companies — these are not public companies. They are limited to 50 members and have limits on their fundraising activities.
- Public companies — any company that is not a proprietary company is a public company.

(b) A Proprietary company would seem the most appropriate. A proprietary company would offer the opportunity for Jenna, Koda, Lula and Asa to all have the benefit of limited liability. All four people could achieve involvement in management of the business if appointed as directors and Asa and others investing in the business could obtain the right to income from the business by being issued with shares. [LO 1.1, 1.6]

1.16 Darryl and Julia are both passionate chess players. They meet for the first time at a chess tournament. After a short discussion about their love of chess, they decide they should open a chess store together selling exotic chess products to other likeminded chess fanatics. Unfortunately, neither Darryl nor Julia have any money. Julia's friend Otis has told Julia he has saved some money and is looking to invest it in a business. Julia and Darryl approach Otis and pitch their chess store idea. Otis is blown away by the pair's enthusiasm for the idea, and agrees to invest \$100 000. The three agree that Otis will not receive any interest on his investment, but will get 50 per cent of the net profits generated by the business.

Darryl is given the responsibility of finding a suitable location for the business. He finds a store in Burleigh Heads and promptly enters into a lease. As Julia is out of town on business, Darryl signs the lease in his name. He then engages a firm of architects to prepare designs for the store.

When Julia returns, she is told about the new premises and takes her good friend Glenda to check out the store. When they enter the store, Glenda trips over a broom that was left lying on the floor and severely injures her leg.

Julia is horrified by the new premises. She doesn't like the location, it is too dark, and it is too expensive. She tells Darryl that the whole chess store idea just won't work, and she has no interest in pursuing the venture any further.

(a) Who is liable for the lease obligations, the architects' fees and Glenda's injuries?

Answer:

Partnership: A possibility when individuals join forces with other individuals in business is to form a partnership, in which all partners share control. A **partnership** is a relationship or association between two or more entities, carrying on a business in common with a view to making a profit. Each partner in a partnership is personally liable for all the debts of the partnership, even if they are caused by decisions or acts by other partners.

It does not matter if the parties have not formally signed a partnership agreement, as formation of a partnership is a matter of contract law. The partnership agreement may be written or oral. In practice, it is always prudent that the agreement be formalised in writing by a competent solicitor. When the parties do not have a formal, written partnership agreement, the partnership Act of the relevant State will set out their rights and liabilities as partners.

As Darryl, Julia and Otis are:

- Carrying on business and,
- In common with each other and,
- With a view to profit

there will be a partnership between the three, which will make them jointly and severally liable for the business debts of the partnership, within the scope of the normal course of the partnership business. The business debts of a partnership may arise in contract, such as the lease, and also for other claims, such as an injury claimant such as Glenda. [LO 1.3]

1.17 Leroy is considering starting a catering business. Leroy has three children (aged three, 16 and 21) and is married to Melanie.

The proposed business will cater to high-end corporate clients and wealthy individuals. In order to have the ability to cater events for these clients, Leroy needs approximately \$4 million of capital. Leroy intends to invest \$2 million into the enterprise from his own funds and get the balance from third-party sources. Leroy wants to have his wife and children involved in the business as well.

- (a) Advise Leroy.**
- (b) How would your advice change if Leroy said his friend Linus owned a commercial kitchen and he wanted to invest that asset in the business for a 25 per cent interest in the business?**

Answer:

(a) The three options available are partnership, company or trust.

Partnership: A possibility when individuals join forces with other individuals in business is to form a partnership, in which all partners share control. A **partnership** is a relationship or association between two or more entities, carrying on a business in common with a view to making a profit. Each partner in a partnership is personally liable for all the debts of the partnership, even if they are caused by decisions or acts by other partners.

Trust: A **trust** is a relationship or association between two or more parties, whereby one party holds property (e.g. investments or assets) in trust for the other; that is, they are vested with the property.

Company: As a separate legal entity, a company has the powers of an individual and it can therefore enter into contracts, sue and be sued in its own name. Furthermore, the owners of most companies have only limited liability for the company's debts. Another advantage of the corporate form is that a company has an indefinite life. Once registered a company will exist until it is deregistered. Compared with other business structures, the owners of a company can easily transfer their ownership interest by selling their shares in the company to other investors.

(b) Matters to consider include:

- As Leroy's children are under 18 they cannot be directors or partners. A trust enables a legal person (adult or company) to be the trustee, but the beneficiaries can be anyone including minors. Beneficiaries participate in the distribution of revenue from the trust business, but beneficiaries have no right to participate in the business itself.
- Financing – if the business needs to take on substantial debt from third-party sources, limited liability for Leroy and his family may be desirable, as the debts of the company belong to the company.
- Succession Planning, particularly when the children turn 18
- If a partnership is involved does Linus's kitchen become partnership property? If the business becomes a company, then the company as a separate legal entity is able to acquire the legal title to Linus' property in return for an equity share, such as share capital.

Instructor manual to accompany Company law: an interactive approach 2e by Chapple et al. Not for distribution in full. Instructors may post selected solutions for questions assigned as homework to their LMS.

[LOs 1.1, 1.3, 1.5, and 1.6]