OXFORD LAW GUIDEBOOKS

BUSINESS LAW GUIDEBOOK

SECOND EDITION

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CHAPTER 9: CHOICE OF BUSINESS STRUCTURE

TEST YOUR KNOWLEDGE

1. What is the sole trader form of business organisation?

ANSWER

The sole trader form of organisation is the simplest and most common way of conducting a business. It has the attractions of simplicity and personal control. A sole trader or sole proprietor, as the name implies, is a person who owns his or her own business or businesses. Such a business structure has become very popular in Australia, especially among those people who, having lost their employment, decide to start a business on their own. There are many sole traders in every state who assume the responsibilities of owner, manager and risk-taker. Such traders can be found in businesses where the owner does all the work and those in which many people are employed. In Australia, there are thousands of sole traders such as builders, plumbers, electricians, bricklayers, builders, doctors, dentists, and lawyers to name a few.

2. What are the requirements that need to be satisfied before you can say that a partnership exists?

ANSWER

A partnership has two requirements. It must be business:

- being carried on in common
- being carried on with a view to profit.

3. Is it a requirement that partnerships be profitable?

ANSWER

Partnerships do not have to be profitable, but they must be created with a view to profit.

4. Explain the essential difference between a partnership and a joint venture.

ANSWER

A partnership is a business that is carried on in common, and where there is a view to profit sharing, and an integrated structure. There are also in a partnership mutual rights and obligations between the parties on whose behalf the business is carried on. A joint venture is an association of persons formed to undertake a commercial activity, mining or other financial endeavour, with a view to mutual profit. A joint venture has a less integrated structure than that found in a partnership.

5. What is the duty of a trustee?

ANSWER

The trustee has a fiduciary relationship with the beneficiary. The trustee in such a relationship has a duty of trust and care, while acting always in good faith on behalf of the beneficiary.

6. Can a trustee benefit under a trust?

ANSWER

A trustee only has the right to be reimbursed for expenses involved in carrying out duties related to the trust. He or she can use trust property to pay for expenses incurred on behalf of the trust, except where the terms of the trust state otherwise.

7. Identify, define and explain the types of trusts in the business world.

ANSWER

There are many kinds of trusts. An express trust is created by the intentional act of a person, the settlor. These trusts are called direct trusts or declared trusts. They can be created by words, written or spoken. The words must be clear and must indicate an intention to create a trust. They must make known the trust property, indicate the nature and purpose of the trust and identify the beneficiaries. These trusts are popular because they are flexible and simple to operate. Non-express trusts are created without any intentional action by the settlor. These can take the form of an implied trust which is a trust that arises where there is no intention to create a trust.

A trading trust is a trust over goodwill and business assets by which a trustee or a third person conducts a business according to or under the authority of the terms of a trust instrument. The trustee is given extensive powers of trading, and is able to incur debts on behalf of the trust. The business is carried on by the trustee.

A discretionary trust is a trust that allows the beneficiaries to be chosen at the discretion of the trustee. The trustee has discretion as to when any payment from the trust fund will be made and the amount of the payment. The trust should specify how the discretion will be exercised and who should exercise it, and the amount of money that should be allocated. Such a trust can be found in small to medium-sized family-owned businesses. This is a widely used kind of trust. It is flexible, simple to operate, and is useful for tax purposes since it is an income-splitting device.

In a fixed trust, each beneficiary has an equal share in the trust, and the trustee has no discretion in the distribution of the income and property. The unit trust is a variation of the fixed trust where the number of units held by a person is evidence of that person's entitlement to profits and property distribution. Unit trusts are offered to the public and all the beneficiaries are the unit holders.

8. What are constructive trusts?

ANSWER

A constructive trust arises in situations where by operation of the law, it would be inequitable (unfair) or unconscionable for a person to retain or keep property for their own benefit: *Baumgarter v Baumgartner* (1987) 164 CLR 137. It comes into existence by operation of the law and not by an express or implied intention to create a trust. It happens, for example, where two people paid for the purchase of a property, but it is in the name of only one of them, not on the basis of any actual or implied intention of the person holding the property. It would be inequitable, in these circumstances, for such a person to hold the property or interest for himself or herself. In this sense, constructive trusts, unlike express or implied trusts, are imposed to answer or fulfil the demands of good conscience and justice.

9. How are all trusts classified?

ANSWER

It is possible to classify all trusts into two broad groups: private and public trusts. A private trust is one that is for the benefit of private individuals (specific people). This can be an express or non-express trust. A public trust is one that benefits some public purpose via charitable institutions (i.e. a trust that benefits, for example, the Salvation Army or Wesley Mission). Such a trust may also be express or non-express.

10. Explain the concept of good faith in franchise agreements.

ANSWER

Good faith is implied in many franchising agreements. The parties must to a certain extent rely on the principle of mutually exercising good faith. The concept of good faith or fair dealing can be seen as trust, taking into account loyalty to the contract and demanding a restraint on self-interest: *Burger King Corp v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (New South Wales Court of Appeal).

11. What redress can the aggrieved franchisees have under the *Australian Consumer Law*?

ANSWER

One redress for franchisees who have been induced to enter into a franchise agreement as a result of misrepresentation by franchisors is to bring proceedings for misleading or deceptive conduct under s 18 of the *Australian Consumer Law 2010* (Cth) (ACL). The aggrieved franchisees may also bring an action against the franchisor for breach of s 29 of the ACL for false representations.

12. Discuss the advantages and disadvantages of incorporation.

ANSWER

Advantages of incorporation are separate legal entity from shareholders or members as well as those who control the company's operations; limited liability; transferability of shares; and perpetual succession. The disadvantages area limited management role for shareholders; onerous administrative requirements imposed by the law; high establishment fees; a limited management role for shareholders; onerous reporting requirements; and heavy legal responsibilities for company officers and directors.

