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ESTABLISHING A BUSINESS ENTITY IN AUSTRALIA

ILN CORPORATE GROUP

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CHAPTER CONTRIBUTORS & FIRMS

"Establishing a Business Entity in Australia"
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1. Types of business entities

1.1 Types of entities available through which to conduct business

The following entities are recognized as business structures to conduct business under Australian law:

Sole trader

A sole trader is the simplest form available as a business structure where an individual trades under their own name or under a registered business name. It is easy to set up as there are few legal and tax formalities required. The business name is easily registered for a minimal fee. A sole trader does not need a separate Tax File Number (TFN) or business bank account, unlike a public or private company. An individual operating as a sole trader has full control over all assets and business decisions and can hire employees as required. Business losses can be written off to other personal income. However, a sole trader is personally responsible for the entire business including any debts incurred. Because of this unlimited liability the sole trader's personal assets can be seized to recover a debt. Hence, this structure is only suitable for micro to very small businesses.

Partnership

A partnership has some similarities with the sole trader structure but involves multiple individuals (or companies) who share control of the business. The structure is very flexible, without any obligation to publicly disclose reports or accounts. However, similarly to a sole trader, a partnership is not a separate legal entity, and the partners are personally liable for the debts of the business. This structure is often chosen by professional services organisations and sometimes by family owned enterprises. A formal partnership agreement or deed is commonly in place to govern the relationship. Partnerships are rarely used for trading companies.

Company

A company is a separate legal entity that has the same rights as a natural person, its own bank account, holds assets, and incurs its own debt. The liability of the owners (shareholders) of the company is generally limited to their capital contribution. Directors of the company must comply with all obligations under the *Corporations Act 2001* (Cth). There are several types of companies under Australian law:

- **Proprietary private company limited by shares (Pty Limited)**

  A proprietary private company is limited to 50 non-employee shareholders. There must be at least one director who has their ordinary residence in Australia. There is no legal requirement for a secretary.

  Typically, not all constituent documents must be lodged with the Australian Securities and Investment Commission (ASIC).

- **Public company**

  A public company does not have an upper limit on the number of shareholders. Capital can be raised from the public by offering shares and other securities. However, there are more reporting and disclosure requirements than with a proprietary company. There must also be at least three directors of which at least two must ordinarily reside in Australia, as well as one secretary. The level of reporting requirements depends on the whether the company is either not a disclosing entity or a company limited by guarantee.

Discretionary or unit trust

A trust is a form of businesses structure frequently used in Australia. A trust is an arrangement where a trustee holds an investment, or the legal title to property, on behalf of named beneficiaries. Trusts are distinct in that they are not separate legal entities and therefore cannot enter into agreements and must nominate trustees that act for them. A trustee is usually a private person or a corporate trustee whose sole purpose is to act as trustee for the trust. The trustee has duties to the beneficiaries, dictated by the trust deed, legislation, and the general law.

There are two main forms of trusts: unit trusts and discretionary trusts. The latter is typically used for family tax and planning purposes. Under this form, the trustee has a choice in regard of the distribution of the income and capital of the trust to any of the beneficiaries named in the trust deed. Under the unit trusts, generally used as a vehicle for public investment schemes, the trustee issues units, each of which grants upon the unit holder a proportionate interest in the overall assets and undertaking of the trusts.

Incorporated or unincorporated joint venture

A joint venture is like a partnership in that it is formed by a group of individuals or companies seeking to combine their resources to conduct an enterprise. However, unlike a partnership, the liabilities and debts incurred typically stay with the parties separately. The relationship between the parties is governed by a detailed joint venture agreement. Careful structuring of this agreement is necessary to ensure that the joint venture is not treated as a partnership for tax purposes. A joint venture usually has a definitive end and does not provide for an ongoing relationship between the parties. A joint venture may be incorporated or unincorporated.

Managed investment schemes

A managed investment scheme, also known as a managed fund or collective investment, is a structure which allows groups of individuals to pool capital for a common enterprise. The scheme is managed and operated by a 'responsible entity' which is subject to Australian financial services licensing requirements. Investors do not have day to day control over the actions of the scheme.

Australian branch

Foreign companies established in non-Australian jurisdictions wishing to directly carry on business in Australia may establish a branch office, usually as an alternative to incorporating a proprietary limited company. A branch office is set up by registering the foreign company with ASIC and is not a separate legal entity. The foreign entity is therefore subject to Australian reporting and disclosure requirements

1.2 Matters to be considered when choosing a particular business entity type

For many foreign companies, a key decision is whether the business will be run through the relevant offshore entity or whether to set-up an Australian entity. In making this decision, one should consider the implications of taxation, employment law, contractual and operational requirements. There is no definite rule as to which entity to use, as there are various modes of market entry and structures that can minimise risk and maximise value. The solution very much depends on the specific circumstances and objectives.

Operating through a non-Australian company

If a decision has been made to expand an overseas business into Australia without creating a local entity and by using a foreign company as a vehicle, the foreign company must be registered with ASIC. This process can take between four to eight weeks. The foreign company must appoint a local agent for the service of notices and maintain a registered office in Australia.

As the operating entity in Australia, the foreign company will be subject to Australian legislation and taxation laws and other related compliance standards. The foreign company is subject to the Australian legal framework.

Operating an Australian business through a non-Australian company often involves complex considerations and it is strongly recommended that appropriate advice is attained.

Setting up an Australian entity

Foreign companies often choose to set up a local subsidiary to conduct business in Australia. The most frequently used entity is a proprietary private company limited by shares (Pty Limited).

2. Steps and Timing to Establish a Pty Limited company

As the Pty Limited company is by far the most common vehicle used by foreign companies expanding into Australia we limited our explanation for market entry to this structure.

Incorporating an Australian Pty Limited company can be done relatively quickly and without great expenditure, involving minimal government fees and corresponding professional fees. With all relevant data ready, a new Pty Limited company can be incorporated within a few days.

Company name and Australian Company Number (ACN)

Before deciding on the name for a new company, it should be confirmed that the proposed company name does not infringe any intellectual property rights of third parties. A company name can be reserved before incorporation takes place.

Following incorporation, each company will be allocated with a unique nine-digit Australian Company Number (ACN). Directors should ensure that the company's name and ACN appears on all relevant public documents.

Low minimum share capital requirement

In Australia, there is no minimum share capital requirement for Pty Limited companies. It is acceptable and not unusual to incorporate a Pty Limited company with a share capital of A$100.

Company directors

The company must appoint at least one director who ordinarily resides in Australia. Directors of Australian companies must be natural persons and at least 18 years old. If there is at least once director with ordinary residence in Australia, the company may appoint one or several foreign directors.

Company secretaries

The company may appoint a secretary. If a Pty Limited company does not appoint a secretary, each director of the company is liable for a breach of the responsibilities of a secretary. If appointed, at least one secretary must have their ordinary residence in Australia.

Public officer

Each company must also appoint a public officer who is responsible for complying with tax obligations and dealing with Australian tax authorities. It is common for an individual to act as both public officer and secretary.

- **Further registrations**

  Further steps are required for the company to become fully operational. This includes tax registrations and if the company is to employ staff, the set-up of a pay-roll, as well as workers compensation registration and superannuation set up.

3. Governance, Regulation and Ongoing Maintenance

3.1 Regulation and ongoing maintenance, reporting requirements

Australia has numerous corporate governance regulations and guidelines, generally provided for in the *Corporations Act 2001* (Cth) and its supplementary rules.

Tax registration and reporting obligations

Every company must obtain a TFN from the ATO and ensure the company complies with the reporting obligations to various regulatory bodies, including the ATO, ASIC and various other agencies. This includes preparing and lodging financial reports with ASIC. In some circumstances relief from financial reporting may apply.

A company must report changes to its company details to ASIC.

As an operating business, a company will also have to apply for an Australian Business Number (ABN). It is generally necessary to hold an ABN to register for the Australian Goods and Services Tax (GST).

Australian taxation is based on a self-assessment model, where taxpayers are responsible for lodging their own tax returns. Individuals and companies are required to lodge an annual income tax return, while companies and other entities may have further requirements for the purposes of GST and Pay As You Go (PAYG). PAYG is a system of paying instalments during the income year towards a company's expected tax liability. Under the withholding tax rules, the payer must withhold an amount from payments made and then pay that amount to the ATO, usually in regular instalments throughout the year, depending on the size of the entity.

When operating a business in an overseas location, as well as in Australia, taxation should be considered including GST implications on the relevant transactions, payment of withholding tax, the application of relevant double taxation agreements and transfer pricing rules.

The income tax rate is 30% for all companies except small businesses. The tax rate for small businesses has been cut to 27.5% from the 2016-17 financial year. This reduced rate is applicable to small businesses with a turnover of under A$10 million and which are companies, corporate unit trusts or public trading trusts.

CGT is imposed on gains realized from the sale of assets with special rules applicable to the valuation of capital gains. For taxation purposes, the assets subject to CGT are very broad and include both tangible and intangible assets. If you are an Australian resident for tax purposes, CGT will apply to assets located anywhere in the world (not only those located in Australia).

Dividends paid by companies to their shareholders are included in the shareholders' assessable income and are subject to a dividend imputation system. The purpose of this system is to pass on a credit to shareholders for the tax that the company has paid on the profits from which dividends are paid. This system therefore ensures that dividends are ultimately taxed at each shareholder's applicable income tax rate and are not subject to double taxation. Access to credits, however, only applies to Australian resident shareholders.

A tax consolidation regime also applies for 100% owned group companies, allowing them to consolidate as a single entity for income tax purposes and ignore transactions within the group for the purposes of income tax.

Please note that the income tax year in Australia is from 1 July to 30 June and not the calendar year.

- GST

GST is a consumption tax (like the Value Added Tax or 'VAT' in other countries) imposed on the sale of most real property, goods and services. The GST may apply to supplies located in Australia as well as those supplies which may be outside Australia.

It is levied at 10%. Some supplies such as certain types of food, exports, education, and health are excluded from GST. All consumers are required to pay GST when making a purchase.

Businesses or individuals carrying on an enterprise that have an annual turnover of more than a specified amount are required to register for GST purposes. GST is reported through a Business Activity Statement (BAS) and is lodged on either a monthly, quarterly, or annual basis.

There is a simplified GST registration regime that may be available for non-resident entities.

These businesses may either be liable to the ATO or entitled to a refund each period depending on the balance of the amount of GST collected through sales compared to any tax credits received from GST paid on goods and services purchased during carrying on their enterprise.

Certain special reverse charge rules apply in certain circumstances with entities located overseas that are making supplies to Australian businesses.

- Fringe Benefits Tax (FBT)

FBT is imposed on the value of non-cash benefits provided by employers to employees.

Generally, benefits must be connected to the employee's employment to be taxable, although certain fringe benefits are either specifically subject to FBT or expressly excluded under Australian law.

The FBT year runs from 1 April to 31 March. FBT is levied on the provider of the benefit at a flat rate of 47% for the year ending 31 March 2018 and may be deductible against the employer's taxable income.

- Medicare Levy and Medicare Levy Surcharge

Medicare is Australia's public health insurance scheme. It operates by receiving contributions through the Medicare Levy and the Medicare Levy Surcharge, which are taxes imposed on Australian residents' taxable incomes.

The Medicare Levy is imposed at a flat rate of 2% of an individual's taxable income, although exemptions may be given to low income earners and foreign residents.

The Medicare Levy Surcharge is an additional flat rate of between 1-1.5% imposed on high income earners who do not have private hospital insurance.

- Superannuation tax – the Superannuation Guarantee Charge

In Australia, an employer must pay a minimum level of superannuation (known as the superannuation guarantee) to its employees to ensure that workers have money set aside for their retirement.

The current superannuation guarantee rate is 9.5% of everyone's employment earnings. With recent amendments coming into effect, the minimum rate will increase progressively over the next years until it reaches 12% from 1 July 2025 onwards.

If an employer fails to provide the minimum level of superannuation, they become liable to pay the Superannuation Guarantee Charge (SGC) which includes the amount of the shortfall in superannuation payments plus interest and administrative charges. However, in practice, most companies will contribute the minimum level of superannuation to avoid the SGC.

There are statutory limits to how much employers or employees may contribute to superannuation funds. If contributions are made in excess of these limits, a penalty charge may apply.

- Luxury car tax

The luxury car tax rate is 33% and imposed on vendors and importers of luxury cars in Australia. There are guidelines classifying a luxury car and the circumstances in which the luxury car tax arises. The tax generally applies to cars valued over approximately either A$65,000 or A$75,000, depending on the fuel consumption of the vehicle.

Other considerations when trading between Australia and other countries

- Transfer pricing

Australian transfer pricing rules must be considered where goods or services are bought or sold between Australia and other countries.

The transfer pricing rules have particular relevance to transactions between related parties in a corporate group for the supply of goods, services or finance that are not priced on terms which would be comparable to those that would be charged between parties transacting at arm's length.

If an international transaction does not occur at arm's length or is not supported by an acceptable pricing methodology, then market prices may be substituted into the transaction for taxation purposes to ensure an appropriate level of tax is paid.

For an intra-group cross-border transaction to be deemed to have occurred at arm's length, the ATO requires that companies appropriately document the transaction as well as the pricing methodologies used for the purposes of the transaction.

Other factors that may be considered by the ATO include, amongst other things, the commercial justifications for the transaction, any applicable review processes and whether any alternatives were considered.

- Customs duty

Customs duty is imposed on goods imported into Australia. The rate of customs duty is generally around 5% of the customs value of goods, although this subject to change depending on the type of good imported.

The customs value of a good is determined as a question of law, considering the type of good, its country of origin and the purpose of its import into Australia.

Customs duty is payable on the entry of the goods into Australia. The applicable duty rules will depend on how the classification of the goods by the relevant Australian authority and may be altered by tariff concession orders or free trade agreements.

Australian customs duty rules are complex, and importers should seek advice on a case by case basis.

- Excise duty

Excise duty is imposed on alcohol, tobacco, fuel, and petroleum products that are produced or manufactured in Australia.

If these products are imported into Australia rather than produced or manufactured in Australia, customs duty applies to their importation at a rate comparable to the excise rate (see above).

Excise duty is paid by either the manufacturer or distributer at a flat rate. The applicable excise rates may increase twice a year to reflect inflationary changes.

In addition, a licence is generally required to undertake activities in relation to excisable goods.

Obligations under the Competition and Consumer Act

Companies must ensure compliance with *the Competition and Consumer Act 2010* (Cth) (CCA) or be subject to penalties.

The main provisions relevant to all companies operating in Australia are summarized below.

- Anti-competitive agreements - Contracts, arrangements or understandings which have the purpose or likely effect of substantially lessening competition are prohibited in Australia, unenforceable and may result in substantial penalties.

Further specific prohibitions include:

- Price fixing – where parties in competition with each other enter into a contract, arrangement or understanding, which has the purpose or effect of fixing a price for the provision of goods or services.

- Exclusive dealing where a company (Supplier) supplies goods or services on the condition that the company that receives those goods or services (Receiver) will not acquire goods or services from a competitor of the Supplier, or that the Receiver must also acquire certain other goods or services directly or indirectly from the Supplier, and this arrangement has the purpose or likely effect of lessening competition in a market.

- Third line forcing is a more specific form of exclusive dealing. An offence occurs when a Supplier supplies goods or services on the condition that the Receiver will acquire different goods or services from a third party. In Australia third line forcing is an automatic breach of the CCA and is punishable regardless of its effect on competition in a market.

- Resale price maintenance occurs when a company dictates to its resellers the minimum prices for the resale of its goods or services. Although a retail price can be recommended, companies will in breach if they threaten not to supply goods, if those goods are not sold at the retail price requested or, otherwise, exert pressure on retailers to sell at a specified price.

- Consumer protection

  By law, companies are prohibited from engaging in misleading or deceptive conduct during trade or commerce.

  This prohibition has a broad interpretation and includes activities such as advertising, oral representations, as well as representations in respect to contractual matters. The consumer protection provisions of the CCA should always be considered when offering goods or services in Australia.

- Product liability

  Companies that manufacture goods in Australia or import goods into Australia will be liable for defects to those goods. Defects include design, manufacturing, and instructional defects, which may or may not have an impact on safety. Whether a defect will be compensable depends on the circumstances and, whether loss or damage has been suffered.

- Unconscionable dealing

  Companies must not act unconscionably in business transactions. Broadly speaking, conduct is unconscionable if the conduct is clearly unfair or unreasonable, or if the company knew, and took advantage of, the special disability of a contracting party.

3.2 Requirements for local directors

The legal obligations summarized below represent a non-exhaustive list of legal requirements which directors of an Australian company must comply with. As directors can become personally liable for decisions made in their capacity as a director of a company, it is critical that directors understand and adhere to all obligations imposed on them.

Appointment as a director

In Australia, every person from the age of 18 years or older who has not previously been disqualified from becoming a director of an Australian company may be appointed as a director of a company. Unlike other jurisdictions, directors need not reside in Australia or be Australian citizens; however, at least one company director must have their ordinary residence in Australia.

To be appointed as a director, the director must sign a notice consenting in writing to be appointed and act as a director of the company. The director must also provide the company with certain personal information about themselves.

If no special circumstances apply, a director may resign from their directorship at any time by giving written notice to the company.

Fiduciary duties owed to a company

On appointment, the director owes various fiduciary duties to their company which, if breached, may lead to personal liability of the director including civil and criminal penalties and liability for damages.

Duty to act honestly

The director must act in good faith, in the best interests of the company and for a proper purpose. This broad duty demands more than general honesty. A director must exercise independent judgment considering relevant facts, materials and other views when assessing the best interests of the company.

A breach of this duty that involves fraud, dishonesty and even recklessness may attract criminal penalties.

Duty not to improperly use inside information or position

A director must not make improper use of their position or information acquired during that position, to gain an advantage for himself or any other person or to cause detriment to the company. In considering whether there has been improper use of their position, it is of no consequence whether the director intended the impropriety to have a certain outcome.

A breach is likely to occur where a director uses information acquired during their position for their own benefit rather than for the benefit of the company.

Duty to avoid a conflict of interest and to disclose material personal interests

All directors must disclose all personal interests that the directors have in relation to the affairs of the company. All directors must, as soon as they become aware of a conflict of interest, notify the board of such conflict.

Directors of proprietary companies, however, need not give notice as to a conflict, provided the other directors are fully aware of the nature and extent of the relevant director 's conflicting interests.

The procedure for dealing with conflicts of interest depends on the circumstances and usually requires specialist advice. In some instances, it may be appropriate for a director to disclose a conflict and refrain from voting on the issue. In other instances, the director's resignation may be required.

Duty not to abuse a corporate opportunity

Like the duty to disclose material personal interests, a director has a duty to not take advantage of a corporate opportunity for personal gain and at the expense of the company.

Only where such an opportunity is properly considered and rejected by the company can a director pursue the opportunity personally, pending the necessary disclosure requirements.

Duty of care and diligence

A director is required to discharge its duties with the same degree of care and diligence that a reasonable person in a similar position would exercise. Factors such as the size of the company and experience, position and responsibilities of the director are considered in establishing this objective standard of care.

A director may not be liable for breach of the duty to exercise care and diligence if the director:

- made the decision in good faith for a proper purpose;
- rationally believed the decision was in the best interests of the company after having made all reasonable inquiries necessary to inform themselves about the subject matter of the decision; and
- made the decision while having had no personal interest in the matter.

Duty not to engage in insolvent trading

Each director has a duty to prevent the company from trading while insolvent and to prevent the company from trading in a way that will make it insolvent.

When a company debt is incurred, if a director is aware that or has reasonable grounds to suspect that the company is or may become unable to pay its debts as and when they fall due, the director will be in breach of this duty. The director may become personally liable for the debt and be ordered to pay compensation to the company or its creditors.

A director will be deemed to have been aware of the company's insolvency if a reasonable person in the position of the director would have been so aware.

Other than being ill or otherwise incapacitated, a director will only have a defence if they can demonstrate that there were reasonable grounds on which to expect the company was, and would remain, solvent.

Duty to keep proper accounts and records

Each director is required to ensure the company prepares a financial report and a directors' report each financial year in accordance with the relevant reporting requirements.

While small proprietary companies may be exempt from lodging all the information required of larger companies, each director must inform themselves of accounting and recording obligations. Specialist accounting advice is usually necessary and recommended.

3.3 Requirements for local shareholding

Unlike other jurisdictions, there are no requirements for an Australian company to have a local shareholder. The company can be fully owned by a foreign company.

3.4 Minority shareholders' rights and protection

The issue of shareholder's rights and protection in Australia is complex. Two of the most important considerations in this respect are listed below.

Oppression of minority shareholders

There are far-reaching remedies set out in section 233 of the *Corporations Act 2001*(Cth) for oppression of minority shareholders. The concept is generally used in reference to conduct falling under section 232 of the *Corporations Act 2001* (Cth). The practical implication is that oppression occurs where a minority shareholder is treated unfairly by majority shareholders who misuse their influence and control over the company. Oppression of minority shareholders can lead to different orders including an order that the company be wound up.

Right to call a general meeting

One or several shareholders with at least 5% of the votes may request to call a general meeting in accordance with section 249D of the *Corporations Act 2001* (Cth).

4. Foreign Investment, Thin Capitalisation, Residency and Material Visa Restrictions

4.1 Barriers to entry for an offshore party

Certain foreign investments, for example certain real estate investments and significant businesses investments, must be approved by the Foreign Investment Review Board (FIRB) before they may proceed. Certain other investments (for example in defence or media companies) also require FIRB approval. Other than that, there are no significant barriers to entry for an offshore party. As mentioned above, a Pty Limited company needs to have at least one director who resides in Australia, but there are no local shareholding requirements.

4.2 Capitalisation obligations

There are no minimum capital requirements for the incorporation of a Pty Limited company.

Foreign entities investing in Australia are subject to thin capitalisation rules that govern the level of debt-to-equity a company must hold. This means that the amount of debt used to fund Australian operations must be limited. The thin capitalisation rules prevent an entity from claiming a deduction for expenses incurred relating to this debt (debt deduction), such as interest payments.

However, inward investing entities are not affected by the thin capitalisation rules if their debt deductions, including those of any associated entities, are A$2 million or less for the income year.

4.3 Business or investment visa

Significant restrictions apply to foreigners which want to obtain a work visa in Australia. There are many different visa classes which may apply such as the ETA Visa, the Class 188 Visa, the Class 400 visa and the Class 457 Visa. At the time of writing of this guide (August 2017), the Class 457 Visa is the most frequently used long-term visa in Australia. However, the Australian Government has announced that the Class 457 visa will significantly change in 2018. Immigration and work permits are a political topic in Australia and the rules governing visas are expansive and change constantly. It is advised that any person wishing to enter Australia contacts a registered migration agent to obtain appropriate advice.

4.4 Restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

There are cash reporting obligations under the *Financial Transaction Reports Act 1988* alongside the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*. It is a requirement to report international currency transfers of A$ 10,000 or more for the purpose of detecting tax evasion and money laundering.

Certain payments (dividends, interest) attract a withholding tax in Australia. Detailed tax advice should be sought on these topics.