Business structure basics – a guide for Farming Together groups

What is the best business structure for your farming group?

Informal farming groups can collaborate successfully, but soon require legal and financial clarity. Then, they need a formal structure. To receive direct Farmer Group Project funds, a group must form an incorporated entity or be sponsored (auspiced) by one. Some entities are more collaborative than others and each type has different values. A sustainable structure is an important choice for collaborators.

How will you choose?

Groups should clearly identify and document why they are coming together, to ensure the structure is a good fit for the business. Entity choices need to be investigated and communicated to potential members, to avoid misunderstanding. It is possible to change later, but such change comes at significant cost and inconvenience. Groups should ask each other about:

Key considerations

- Purpose (aims, reason for collaborating, trading or not trading and profit intention)
- Size
- Legal status/member liability
- Law (legislation and entity structure rules)
- Member equity movement and winding up
- Raising capital
- Voting rights
- Profit distribution
- Registration
- Set-up and compliance
- Taxation

These issues will be explored in detail >>

Before proceeding, it is important to note the difference between …

Incorporated or unincorporated?

An *incorporated* structure is a separate legal entity to its members. It can enter into contracts, operate bank accounts, own assets and borrow, all in its own name. It can sue and be sued and continues to exist, even if its members change. These formal structures have registration, reporting and regulation requirements governed by state or federal agencies. Rules and regulations cover: ownership, operations, governance, responsibilities and protections for members and elected representatives.

Recognition as a separate legal entity provides some protection for elected representatives and members by limiting personal liability (to the value of shares held). There are some exceptions to this rule for elected representatives and groups should seek legal advice in this area.

Common examples of incorporated structures:

- Proprietary Limited Company
- Limited Co-operative
- Incorporated Association

Co-operatives, growing in numbers, are a sustainable collaborative structure and have origins dating back to the 1800s. The values underlying a co-op include: democracy, equality, equity, solidarity, self-help, self-responsibility, and co-operation. Membership should be active, voluntary and open and the co-op business should support the education and development of its members and its community.
Co-operatives can be either Distributing or Non-Distributing.

Unincorporated agreements

An *un-incorporated* structure can be either formal (with legal agreements) or informal (with a handshake). For example, an unincorporated partnership might have an agreement while an unincorporated association might operate without one. Unincorporated associations have minimal registration costs and few reporting requirements.

An un-incorporated entity does not hold separate legal status to its members.
This means that members effectively trade as individuals and are personally responsible for the debts and liabilities of the entity. *Farming Together* favours incorporated entities and only provides direct project funding to unincorporated entities under special circumstances, via an auspice (incorporated) entity.

For some groups, limiting legal liability for elected representatives and members will be the most significant consideration in choosing a structure. If you intend to trade with consumers or group members, or you intend to operate for profit, get incorporated. If you only come together for informal discussion or education, or have limited resources, stay unincorporated, but check your eligibility for funding in government programs.

Common examples of un-incorporated structures:

- Partnership
- Un-incorporated joint venture
- Un-incorporated Association

Not for profit organisations can be incorporated or unincorporated, though most would be incorporated. These organisations can make a profit, but cannot distribute that profit to members. Profits must be reinvested in the business. On winding up, surplus funds cannot be distributed to members and are usually donated to charity or the industry.

What's the difference?

Incorporated

- ✓ Formal
- ✓ Entity is separate from members – limits member and representative legal liabilities
- ✓ Examples: Company, Co-operative, Incorporated Association
- ✓ Government programs can fund
- ✓ Strong supporting legislation/entity rules
- ✓ Have registration and reporting regulations (Companies more so than Co-ops or Associations) and set up costs

Un-Incorporated

- ✓ Formal or informal
- ✓ Entity = individual members – members and representatives are legally liable for activities
- ✓ Examples: Partnership, Un-incorporated Joint Venture, Un-incorporated Association
- ☞ Most government programs do not fund directly
- ✓ Legislation/entity rules depend on entity type and internal agreements
- ✓ Minimum registration, reporting and establishment costs and regulations

DISCLAIMER: This information has been produced for Farming Together to assist prospective groups select the best business structure for their group project. Information provided is general in nature and not intended to be an exhaustive comparison of available structures. Groups should not rely solely on this information and should seek professional advice.
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Business structure key considerations

- **Purpose**

What are the aims of the business? Will it trade with members and/or the public? Does it intend to make a profit? Will the profit be shared with the members?

Incorporated Companies and Distributing Co-operatives both have the power to trade with members and the public. They can make and distribute profits to their members. Companies do this by dividends based on shares held and a Distributing Co-op provides either dividends based on shares or bonuses/rebates based on participation (rewarding active members). Incorporated Associations and Non Distributing Co-ops are able to trade with members and the public but profits may not be distributed.

- **Group size**

Does the group intends to raise capital, trade, make and distribute profits? If so, it will need a Proprietary Company or Distributing Co-operative structure.

For groups with more than 20 members, the raising capital rules for companies are far more stringent than for co-ops. Companies wishing to raise more than $2 million or have greater than 20 members, have significant disclosure requirements and may be required to hold an Australian Financial Service licence or appoint a licenced entity. While co-ops also have disclosure requirements for prospective new members, they are not as onerous. Consequently although a Proprietary Company can be a suitable structure for both small and large groups, larger groups face additional requirements for registration, incurring greater costs. Co-operatives and Incorporated Associations offer more flexibility when it comes to group size.

Minimum/maximum member requirements

- Proprietary Company (Private) - **1 minimum**/maximum of 50 non-employee members
  Disclosure requirements for companies with 20 or more members or seeking to raise $2m or more
- Trading Co-operative / Non-Trading Co-operative / Incorporated Association - **5 minimum**/no maximum

- **Legal status /member liability**

Incorporated structures (Companies, Co-operatives and Incorporated Associations) operate as separate legal entities. The entity can enter contracts, own assets and borrow funds in its own name. It can also sue and be sued independent of its members. Liability is generally limited to the entity itself, with members' liability limited to the extent of equity (if any) held by them. Directors can sometimes be held personally liable and groups should seek current legal advice.

☞ Unincorporated entities are not considered separate from the members. **Members are therefore responsible for the entity's activities, debts and liabilities.**

- **Legislative and compliance requirements**

Proprietary Company – Corporations Act and company constitution. Annual company return - ASIC.

Co-operative Limited (Distributing and Non-Distributing) – Co-operatives National Law or Co-operatives Act, constitution or model rules and Disclosure Statement. Annual co-operatives return – State Co-operatives Registrar.

Incorporated Association – Associations Incorporation Act and Association constitution. Annual Incorporated Association return - State Registry Service.

Unincorporated Association – Limited legislative requirements. No compliance requirements.

- **Member equity, movement and winding up**

Proprietary companies record members' equity in issued shares. Shares are issued at an initial value which then changes in line with the company's performance and changing asset values. If members wish to sell their shares, the company assets have to be revalued to determine market value - which can be a practical restriction to the movements of shareholders. Companies require a formal process to wind up their affairs. This may be liquidation (if assets are held in the company), or deregistration - if no assets are held. Both processes usually follow a director's or member's resolution. Retained earnings (undistributed profits) are normally applied as dividends before a return of capital occurs on wind up. A similar process applies to Distributing Co-operatives. The directors and members agree to wind up, liquidate assets and distribute funds by share repurchase or cancellation. Non Distributing Co-operatives and Incorporated Associations generally cannot distribute surplus funds to members.

Co-operatives also record members' equity in issued shares. Unlike companies however, the shares are generally fixed in value and are only revalued if and when a co-operative is wound up. The fixed nature of the share value makes the movement of members in and out of the co-op easier than for companies.

Incorporated Associations don't usually record member equity. On winding up, surplus assets cannot be distributed to members. **Unincorporated entities** can both record and not record equity depending on the type of entity. Unincorporated Partnerships would normally record partners' equity whereas an Unincorporated Association would normally not receive or record members' equity.

- **Raising capital**

The amount of capital to be raised and how member's capital is recorded are key considerations. Both **Incorporated Companies and Co-operatives** usually raise capital by issuing ordinary shares. Additional funds can be raised by borrowing from traditional lenders or via member loans or debentures. Groups need to be mindful of the onerous investment disclosure requirements for Companies with 20 or more members or which seek to raise greater than $2 million in share capital.

Co-operatives can also use financial instruments known as Co-operative Capital Units (CCU). These were introduced so that co-ops can raise capital for expansion and can be either debt or equity; issued to both members and non-members. CCUs do not carry the same rights (eg. voting) as member shares.

The share value of a Company reflects the market value of the assets held in the company. The share value of a Co-operative is fixed until that co-op is wound up. Incorporated Associations do not have share capital and usually raise funds by subscriptions, grants, loans or fund raising. Unincorporated entities generally do not have share capital but can record members' equity through capital accounts.

- **Voting rights**

Voting rights for **Proprietary Companies** are attached to each share. Larger shareholders have more voting rights than smaller shareholders and can effectively control the company.

Voting rights for a **Co-operative** are attached to membership, ranking all members equal in status and voting rights. The Co-operative's Act protects against concentration of ownership by placing a limit of 20% on the level of shares held in the share capital by any one member. Voting rights for Incorporated **Associations** are usually addressed in the association's constitution but would normally be based upon membership. Voting rights for unincorporated entities may be informal or addressed within the entity's agreements and or legislation (Partnership Act).

- **Profit distribution**

Both Proprietary Companies and Distributing Co-operatives are able to distribute profits. Proprietary Companies distribute profits as dividends based on share ownership. A Co-operative can either distribute profits as dividends based on share ownership or as bonuses or rebates. Bonuses or rebates are a reward for loyalty, usually based on the level of commercial activity conducted with the co-op business.
Non Distributing Co-operatives and Incorporated Associations cannot distribute profits and must use surplus funds to support their activities. Unincorporated Entities may distribute profits depending on the type of entity agreements and legislation in place.

- **Registration**

Proprietary Companies incorporate (register) through ASIC (Australian Securities and Investments Commission). This can be done manually by the applicant but is more frequently completed by service providers with access to ASIC's registration platform. These providers have developed off-the-shelf registration kits which provide standardised forms including the company constitution. As long as the group's objectives align with the rules and regulations governing the establishment and operation of a Proprietary Company, registration is fairly straight forward and inexpensive.

Co-operatives (both Distributing and Non-Distributing) are registered with the Registrar in each state. Professional assistance is sometimes required to complete the registration but is not always necessary. Co-op registration fees are comparable with a Proprietary Company but there are no off-the-shelf models. Costs to prepare registration documents (draft constitution model rules, disclosure statements and supporting information) can be significantly higher due to the need to customise documents to align with each group's objectives. Farming Together's online **Co-op Builder** aims to help reduce these costs.

Incorporated Association registration is simpler and often completed without professional assistance.

☞ **All incorporated entities have ongoing recording and annual reporting requirements.** Costs associated with recording member details, shareholdings and movement is often under-estimated. The size of the proposed entity will have a direct effect on the cost of registration.

Unincorporated entities generally do not have registration costs but may incur costs in establishing the entity or interposed corporate entities.

- **Set up and compliance costs**

ASIC costs for Companies apply across all states whereas registration and annual return costs for Co-operatives and Incorporated Associations vary from state to state. Costs below are indicative only. Accounting and taxation costs are additional and will vary according to group size and requirements.

Proprietary Company	Distributing Co Operative	Non Distributing Co-op	Incorporated Association
• Registration - $479 • Professional set up - $1000 to $2000 • Annual return - $254	• Registration - up to $500 • Professional set up - $5,000 to 10,000 (depends on size) • Annual return - up to $300	• Registration - up to $300 • Professional set up - $2000 to $5000 (depends on size) • Annual return - up to $300	• Registration - up to $300 • Set up - $1000 to $3000 (depends on size) • Annual return - up to $250

- **Taxation**

All business entities are subject to GST. However, Not-for-profit Incorporated Associations and Non Distributing Co-operatives may be exempt from normal tax requirements. Groups should seek professional advice on eligibility. Companies and Distributing Co-operatives are generally taxed as companies. Tax paid may be passed on to shareholders as franked distributions. Unfranked dividends are treated differently. For Companies, such dividends are distributed with no tax credit. For Co-operatives they are a tax deduction for the entity, but remain taxable in the shareholder's hands.

Tax advantages for Co-operative Companies

Co-operative Companies are incorporated entities, mostly commodity and livestock businesses, which limit share ownership, do not trade shares and have 90% of transactions with members. These entities can operate like a company; paying tax at the company rate and distributing profits with tax credits (franked distributions). This type of co-op can also pay unfranked distributions which transfers the tax obligation from the entity to the member. The member includes this as personal income which might be taxed at a lower rate. Eligible co-operatives may also claim tax deductions for interest AND principal repayments of some government loans in some states. Eligibility is restricted and does change.

Key Considerations checklist

Key Considerations	Proprietary Company	Co-operative	Incorporated Association
Promotes collaboration between members	Not specifically	Yes	Not specifically
Enables trade with members and the public	Yes	Yes	Yes
Profit sharing	Distributing	Distributing & Non Dist.	Non Distributing
Group size	Limited	5 > Unlimited	5 > Unlimited
Legislation and rules	Corporations Act, company constitution	Co-operatives National Law, constitution or model rules	Incorporated Associations Act, constitution
Separate legal status to members	Yes	Yes	Yes
Limited member liability	Yes	Yes	Yes
Members' equity	Shares	Shares	N/A
Restrictions on member equity/ownership	No	Yes	N/A
Share value on entry/exit	Revaluation	Fixed value	N/A
Voting rights based on	Shares	Membership	Membership
Registration process	Automated – standardised offering	Customised and standardised input and approval	Customised input and approval
Registration costs (assumes professional assistance)	\$1500 - \$2500	Distributing - \$5500 to \$10,000 depending on size Non Distributing - \$2500 to \$5000 depending on size	\$1000 - \$3000
Compliance Requirements	Annual Return Taxation Return	Annual Return Taxation Return (Exemptions and concessions available)	Annual Return (can seek exemption)