

A COMPLETELY REVISED AND UPDATED EDITION
OF THE DEFINITIVE GUIDE TO 'MUSIC BUSINESS'

3RD
EDITION

MUSIC BUSINESS

A MUSICIAN'S GUIDE TO THE AUSTRALIAN MUSIC INDUSTRY
BY TOP AUSTRALIAN LAWYER AND DEALMAKER

SHANE SIMPSON



This chapter is taken from the book *Music Business* by Shane Simpson

More information can be found at
<http://www.simpsons.com.au/musicbusinessinfo.htm>

2

BUSINESS STRUCTURES

GIVEN THE HUGE AMOUNTS OF MONEY THAT CAN BE GENERATED IN THE MUSIC INDUSTRY, IT IS ESSENTIAL THAT YOU STRUCTURE THE BUSINESS OF YOUR MUSIC TO MAXIMISE YOUR OPPORTUNITY FOR PROFIT AND PROTECTION. YOU HAVE MANY OPTIONS AND SHOULD CHOOSE OR MOULD ONE THAT SUITS YOUR INDIVIDUAL NEEDS. THIS CHAPTER INTRODUCES YOU TO POSSIBLE TYPES OF BUSINESS STRUCTURE.

It is only common sense to structure the commercial and legal aspects of your business in such a way that will promote your commercial and artistic aims.

If you are a solo performer or writer, your needs will be different from musicians who are working with others. After all, if you are working by yourself you are working only for yourself and have no-one else's needs to consider. If you are working with others, you must consider the other members of the group and come up with a way to satisfy everybody's needs.

As with most commercial relationships, if the deal isn't fair to everyone involved, it will not last long. Eventually the members in the group who have been hard done-by (or just think they have been) will wake up to what has been going on and start to resent the way they've been treated. That mistrust and resentment usually signals the end of the group but, in reality, the end really began right back when the unfair deal was first made.

WORKING SOLO

Most solo musicians are just 'sole traders'. They don't have any formal legal structure. Most don't need one. The sole trader is the most common, flexible and unrestricted form. To be strictly accurate it is not a structure at all; rather

it is an absence of a structure. Of course, if you are a sole trader you must still obey the general law, but there are few other constraints, no formalities, essentially no supervision and you get to enjoy freedom of artistic and commercial direction.

It perhaps follows that the sole trader is also the most vulnerable: Without the protection of a company structure, the entire financial exposure of the business is the personal responsibility of the individual. There is no limit to that liability. All your money and all your assets are at risk. The only protection is bankruptcy - if you can call that 'protection'. It's more like a mattress at the bottom of a cliff.

It used to be that most solo musicians formed a company and ran their business through it. These days, because of extensive changes in the tax laws, there may be no great tax advantage in using a company to administer your finances. Generally speaking, deductions that a company can claim can also be claimed by an individual (and of course, a company pays tax from the first dollar it earns, whereas individual tax payers enjoy the first few thousand dollars tax free).

However, there still can be some advantages in a solo performer setting up a company. These include:

- (a) Where you are making so much money that you need a tax-effective mechanism for income distribution or to permit the easier transfer of funds overseas, your advisers may suggest that you set up a trust. (Trusts are explained in more detail later.) Such a trust will probably have a company as trustee. The company will control the trust but you will control the company that controls the trust. Yes, this is getting complicated.
- (b) When you perform live, if you contract through a company, the employer does not take the tax out of your fee. This saves the employer the headache of administration and means that you get paid the gross fee. Just make sure you provide for the tax that will have to be paid some time in the future.
- (c) If you are taking on financial and legal risks (for example, the employment of staff or self-promoting your concerts or working in a manner or location that can be physically or financially dangerous) you would be well advised to form a company and enjoy the benefits of limited liability.

The general rule should always be: keep it simple, unless you have a very good reason to complicate it.

WORKING WITH OTHERS

STARTING OUT

As soon as two or more musicians decide to work together (whether long-term or just on a project-by-project basis), some thought should be given to devising a structure so that the parties will understand their mutual rights and expectations.

All too often, artists do not work out the business aspects of their relationship at an early stage. Many, quite mistakenly, seem to believe that the costs outweigh the benefits. Others simply can't be bothered, perceiving the effort as diverting their energy from the more creative aspects of their work. This is fine if the project is a failure. If the song-writing partnership is arid or the band never has success, who cares? But what if the combination works and the money starts coming in? The stresses created by the demands of success almost inevitably mean that it will be more difficult to work out a mutually satisfactory deal between the parties. Success in the music industry is hard enough to achieve at the best of times and the last thing you need is to start infighting about who gets what and why, just when you need to be concentrating on consolidating that early break. Once the physical, emotional and creative strains of success start to influence the members in various ways, reasonableness can become a rare commodity, so plan your business relationship early. It will never be easier to resolve than at the beginning.

THE OPTIONS

Most musicians do not have much money when starting out. Consequently it doesn't seem to make sense to spend a lot of money on lawyers and accountants. That said, you must plan for success. If you are successful you will be thankful that you structured the business properly at the outset.

Your basic options are: partnership, company, a trust, or some combination of these.

PARTNERSHIP

Each State has its own Partnership Act. 'Partnership' is defined as the legal relationship between people who carry on a business in common, with a view to making a profit. The parties' intention is important. If you have a group which you run as a hobby, with no intention that it will make a profit, you may not have a partnership. The expression 'business' is defined as including 'every trade, occupation or profession', so it is very wide-ranging.

If the above factors are present, a court is likely to decide that a partnership exists, whether or not the people involved considered themselves to be 'partners'. No formalities are required. Consequently, many musicians working together are actually operating a partnership without knowing it.

The legal concept of ‘partnership’ can be very important, because each partner is individually responsible for all of the debts or liabilities incurred in the name of the business by any of the other partners. For example, a member of the group may, without permission from the others, purchase an expensive piece of equipment, charge it to the partnership’s account and then go overseas, taking the new equipment. In such a case the remaining partners would be liable for the debt, even though they had not actually approved the purchase nor had the use of the equipment. Given this, you can see the danger in having credit cards and other accounts in the name of the band! The burden upon partners can be heavy.

Also, the group must get an ABN (Australian Business Number) from ASIC. Every partnership has to have one. This can raise complications because each time a member leaves the group and a new one joins, legally, the old partnership concludes and a new one starts up - requiring a new ABN. It will create a problem for your accountants if they are unaware of your line-up changes.

When going into any sort of partnership business, the participants should discuss the basic rules that are going to control their business relationship. For example, if one of the partners is going to get a bigger share of the income, it should be confirmed in writing. In 1999 the English Court of Appeal decided that Morrissey and Marr, the dominant force of the 80’s group The Smiths had been taking a greater share of the income than to which they were entitled. Partners are presumed to be equal unless otherwise agreed. Marr and Morrissey could not rebut that presumption. It wasn’t in writing.

At the beginning of a business relationship, partners often decide that they will not enter a formal, written, partnership agreement because it is time-consuming, involves legal expenses and seems rather pessimistic. This is understandable, but the partners must realise that as the success of their business increases, so too will the strains.

It makes good commercial sense to go to a music lawyer to have your partnership agreement drawn up. You need someone used to doing this specialised work so that you can be sure that he or she knows the most commonly arising problems in the life of a musical partnership.

You will save a lot of your lawyer’s time (and yourself a lot of money in legal fees) if you prepare for your meeting with your lawyer. The following are some suggestions for you to use in discussions, but the list is by no means exhaustive:

PARTNERSHIP CHECKLIST

1. Define exactly what the partners intend doing. Will you be performing? Writing? Producing? Who will do what? Is it just one project (like writing a musical) or will it be ongoing?

2. What work is involved in the project?
3. How many partners will there be? For example, if the group consists of a couple of key members and the others have just joined or are just hired for particular sessions, who should be in the partnership?
4. If not all the members of the group are going to be partners, how will the non-partner members be paid?
5. Will each partner have set responsibilities in the venture? How much time is each partner expected to spend on partnership business? Will it be a first priority or not. (If one member of the group has a full-time job that doesn't permit time off for touring, or another has a spouse who doesn't want their spouse to be out late at night, you have a problem. You might as well know about and deal with these issues sooner rather than later!)
6. What will be the costs incurred in setting up your musical business? Do a budget of anticipated expenses.
 - (i) Where possible, use real figures and get quotes, not guesses. Where you can't, be pessimistic. It always seems to cost more than you thought!
 - (ii) How will the set-up funds and initial running costs be raised? How much will each of the partners have to contribute at the outset?
 - (iii) To answer this you have to do a budget of your set-up costs. What are they?
 - (iv) How much is it likely to cost to run the business? How will the running costs be met?
7. How will income or profits be distributed? There are many different ways that this can be done, e.g. take a group of four people that performs live and makes records. The lead singer put the group together. The keyboard player and the guitarist write the songs that the group performs. The drummer is a very good drummer:
 - (i) What are their various sources of income?
 - (ii) Should each share in all sources?
 - (iii) In what proportions should they share?
8. What decision-making process will be used? There are obvious problems in demanding that all the decisions of the group be unanimous. Just one member, who is having a bad day or who genuinely disagrees with the plan, could frustrate the wishes of the majority:
 - (i) Are there some decisions that should be unanimous?
 - (ii) If so, which are they?
 - (iii) What will be the quorum (i.e. the minimum number of members needed at any given meeting, to be able to make binding decisions)?
 - (iv) Will minutes be kept?

9. Will leaving members promise not to use the business name of the partnership?
10. Will leaving members promise not to use information that is confidential to the partnership or the individual partners? In almost every business, and music businesses are no exception, the participants come into possession of information that is commercially significant and must be kept in confidence. What sort of information might this cover?
11. Where are the partners going to work?
12. What name will be used?
13. The group must set up accounts in the name of the group. The income of the group must never be mixed with the funds of the manager or individual group members. The reasons for this should be obvious. You have to decide:
 - (i) Where will the accounts be set up?
 - (ii) What sort of accounts will the group operate?
 - (iii) Who can operate them?
14. Will all partnership income be paid into the partnership account and will all partnership expenditure be paid from that account, so that a proper financial record is maintained? The old tradition of having a manager take all the musicians' income and hand out net sums to the musicians (after deduction of all expenses, fees and commissions) is, thankfully, becoming less prevalent.
15. Who will be responsible for overseeing financial affairs, including taxation obligations? Who will maintain the books of account?
 Few managers or artists have the necessary skills. Some managers get a poor reputation because they assume these important financial obligations without having sufficient skills for the task. More and more artists are appointing accountants to look after all of their financial affairs. In these cases, the manager takes a few percentage points less in return for being relieved of responsibility for financial administration. Accountants run the bank accounts, keep the books and make sure both the manager and the artist (and everyone else involved) has their proper share of the profits.
 This extra expense is more than justified by the security it gives to all parties. It also encourages everyone to get expert financial advice rather than to try to make it up as they go along (which can be expensive, e.g. if you make a mistake in not paying the right amount of tax).
16. Will all loans to the business by any partner be noted formally in the books and note taken of the terms upon which any loan is made?
17. What will be considered as being partnership income and what will be non-partnership income? Will there be different sources of income? Will all income be dealt with the same way?

18. Who will have the authority to enter contracts and incur debts in the partnership's name? Is there to be a transaction-value limit set on this authority, with any expenditure in excess of that amount needing the approval of the other partners?
19. Are the parties allowed to do work outside the partnership? What if that work competes with the partnership itself?
20. What happens if a partner dies or wishes to resign from the partnership? What is a fair and business-like way of retiring from the partnership? What notice should a retiring member have to give? What payment, if any, will leaving members receive? What will that member's responsibility be for partnership debts or unrecouped advances? What use can they make of the business name and trade marks?
21. How can a partner be expelled by the others? On what grounds?
22. How can the partnership be dissolved voluntarily? How will the assets (and liabilities) of the business be divided?
23. How can the rules of the partnership be altered?

This is not an exhaustive list.

COMPANIES

Unlike a partnership, you can't form a company without going through lots of formalities. The formalities are important because, unlike partnership, what you are doing is creating a legal entity that is quite separate from its members. A company can sue, be sued, hire, fire, buy and sell - all in its own name. With a partnership, the partners always remain individually liable whereas, with a company, the members' liability is strictly limited. It is the company itself that incurs the obligations and liabilities. If a company becomes liable for more money than its assets can meet, it may go into liquidation or be wound up, in which case the personal assets of the shareholders will remain largely intact. (For more details about directors' duties and liabilities, see Chapter 3.)

The most common form of private company is the 'company limited by shares'. You identify such companies by the "Pty Ltd" at the end of their name. ("Pty" stands for 'proprietary', in other words, they are privately owned. They are called 'limited by shares' because you acquire an interest in the company by purchasing its shares. The profits of the company will be distributed to its shareholders according to their shareholdings. (For discussion of companies 'limited by guarantee', see Chapter 3.)

Proprietary companies now only need to have one shareholder (whether a human or another company). If there is more than one, the shareholders can hold the shares in any proportion. Companies only need one director.

The shares may be of several sorts (e.g., voting or non-voting, preference or ordinary, etc.), but usually the percentage of shares held determines the degree of control over the company and the proportion of income that will be received from company dividends.

OBJECTS

In establishing a company, you must remember that it is an artificial creature and can only do the things permitted under its constitution and the Corporations Act.

A company is a highly flexible structure with an almost unlimited range of objects. Indeed, these days, it is not compulsory to nominate any purposes at all! However, there are sometimes advantages in specifying the objects of the company more closely.

LIABILITY

Members' liability is limited to the amount of any unpaid-up value of their shares. Let's say four people form a company with an issued capital of 100 shares, and each shareholder holds 25 shares. Assume that the constitution says each share has a value of \$10. After trading for some years, the company incurs losses of \$100,000. Its assets are only \$50,000. If the company cannot pay its debts the creditors may wind the company up but the shareholders' personal liability will be limited. If the shareholders have each actually paid the full \$10 per share, they pay no more money, but if they have only paid, say, \$1 of the nominal value, the remaining \$9 per share will be payable (i.e. \$9 x 25 shares). The shareholders' other personal savings and assets will be untouchable.

In other words, if you are entering a high-risk business (and what can be more high risk than the music industry) it is a common-sense way to protect personal assets.

WHEN AND HOW TO FORM COMPANIES

The establishment of a company is something that should be discussed with your lawyer and your accountant. Since the introduction of the Fringe Benefits Tax and other taxes, the benefits have been reduced although not entirely removed. Forming a company is probably not worthwhile for tax purposes unless you are earning (or are about to earn) in excess of, say, \$40,000 a year because it is only about that figure that the corporate rate of tax becomes advantageous over personal rates.

As already explained, companies are also useful for limiting personal liability and thus protecting personal assets. This is particularly so when an individual wishes to combine with others in a specific venture but does not

want to be liable (as a partner) for the errors or defaults of another party. It is also possible to choose a company structure to make use of its shares as a way of defining the members' rights to control the venture and their rights to profits; e.g. you can have different classes of shares - with different rights attaching to various classes of share. You will need to discuss this with your advisers before tackling it.

Many people simply buy a 'shelf company' (so-called because it is set up in advance, ready-named, and can be purchased and established without delay). The price for these starts at about \$1,100, although if you want to change its usually inelegant name, it will probably cost extra. The advantage of the shelf company is that it is operative quickly and it can be obtained readily.

These days, it is just as fast to set up a company from scratch. This is slightly more expensive but is preferable as you can tailor the creature to your own individual needs. As with so many things, the structure you choose should be moulded to your particular requirements, not vice versa. Saving a few hundred dollars here can be a very false economy in the long term.

WRITTEN AGREEMENT BETWEEN SHAREHOLDERS

All too often, groups (or their accountants) set up a company but fail to have a written agreement between the shareholders that establishes how they will operate the company. The constitution of the company sets out only the basic machinery of the company. It doesn't deal with the nitty-gritty aspects of the commercial relationship between the individuals involved.

The shareholders' agreement will cover many of the points that are contained in the *Partnership Checklist* (set out earlier in the chapter). Companies are easy to establish. The more difficult, but important, part of the process is to sculpt a shareholders' agreement so that the basic company structure really fits the needs of the individuals who will be working under the umbrella of that company.

To assist your lawyer to draft your shareholders' agreement, review the *Partnership Checklist*, work out which questions are relevant to you and try to work out some preliminary answers. The more information you can prepare for yourself, the less time it will take to draft the shareholders' agreement and the cheaper it will be.

SERVICE AGREEMENTS

Since a company has no hands and feet, let alone any musical ability, it will have to retain the services of musicians. Each musician should have a simple written agreement with the company, spelling out the terms on which they will supply those services. What services will each supply? Will the services be

exclusive to the company or will they be able to do outside work? If so, what work and in what circumstances? How will they be paid? Will there be a superannuation fund set up, so savings can be put away? What rights will they own or control?

OTHER AGREEMENTS

It is important to remember that if the group forms a company, the company must become the vehicle for all aspects of the group's business. It is the company that enters all of the group's music business contracts: Record contracts, management contracts, rental contracts, car and truck hire, side player agreements, studio hire, producer agreements, and everything else that involves money and/or liabilities, should be in the name of the company.

TRUSTS

A trust may be loosely defined as being an arrangement by which someone (the trustee) holds and manages property on behalf of others (the beneficiaries).

Trusts are generally used as a device for splitting income earned by one or more persons amongst a greater number of beneficiaries. This can have considerable tax advantages, although developments in taxation laws have considerably reduced these advantages.

Trust structures used in the music industry can be divided into Discretionary Trusts (in which the beneficiaries' right to income is flexible) and Unit Trusts (in which the right to income is determined by the number of units that have been allocated to each beneficiary). Which you choose will depend on the reason you are creating the trust.

The trustee will usually be a company (generally referred to as the corporate trustee). The corporate trustee enters all the agreements, undertakes all the liabilities, collects all the money and arranges for the payment of the profits to the beneficiaries of the trust. This way, the beneficiaries can get the benefits of limited liability that the company offers while still enjoying any tax advantages that the trust may offer.

You should definitely not enter the world of trusts without very detailed expert advice.