

Choosing a Business Structure

There are 4 main types of business structures for doing business in Australia, each with their own advantages and disadvantages. A person can carry on business as a sole trader, partnership, trust and company.

The choice of business structure is an important decision to make at the start of a business venture, as the structure can impact on tax implications and reporting requirements during the lifetime of the business. When setting up a business structure, consideration should be given to factors such as how many people will be involved in the business, what the business will do, how much income is likely to be earned from the business and the intended growth of the business.

Sole Trader

A person can carry on a business on his or her own behalf, as a sole trader. A sole trader can trade under his or her own name or a registered business name. The income earned as a sole trader is taxed at the same rate as individual tax payers.

This is the simplest form of business structure, with lower establishment costs and with minimal legal and compliance requirements. The main disadvantage to this type of business structure is that a sole trader is personally liable for all obligations incurred in the course of the business.

Partnership

Two or more individuals can carry on business in partnership, where the income from the business is received jointly. Partnerships are relatively inexpensive to form and operate. Most partnerships are established by a partnership agreement which sets out the rights and obligations of the partners. A partnership itself is not taxable, rather each partner pays tax on their share of the net income of the partnership.

The downside to this type of business structure is that partners are severally and jointly liable for the obligations of the partnership. There is also potential for dispute and loss of trust between the partners.

Trust

Under a trust, a trustee owns the property or assets of the trust and carries on the business on behalf of the beneficiaries of the trust. A trustee can be an individual or a company. A formal Deed is required to set up a trust and there are annual tasks for a

trustee to undertake. As such, it can be expensive and complicated to set up and administer a trust.

The advantages of a trust are that there is flexibility in income distribution and income can be streamed to low income tax beneficiaries to take advantage of their lower marginal tax rate. Furthermore, assets can be protected through a properly drafted Deed. The disadvantages are that trusts can be costly to set up and there are more compliance and legal requirements.

Company

A company is a separate legal entity capable of holding assets in its own name. The words “*Pty Ltd*” after a business name show that the business is a registered legal entity trading in its own right. A company is owned by shareholders and directors manage the company’s day to day business and affairs. The shareholders of a company receive any company profits in the form of dividends. Shareholders can limit their personal liability and are not generally liable for the company debts. Instead, the financial liability of the company is limited to the company assets.

Companies are governed by the Corporations Law and there are a number of duties and obligations for company directors. Primarily, directors have an obligation to act in the best interests of the company. Establishment of a company and ongoing administrative and compliance costs associated with the Corporations Law can be high. There is also a requirement to publicly disclose key information.

Conclusion

Each business will vary and no business owners’ circumstances will be the same. It is advisable to talk to an accountant or solicitor about the costs and risks of each business structure to make sure that the business structure used is the right one for the business and its needs going forward.

If you or someone you know wants more information or needs help or advice, please contact us on (03) 9600 0162 or email info@lordlaw.com.au.