Reference Guide

Structure Comparison

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Structure Comparison

There are many things to do when establishing a business – whether it is buying an established business or starting from scratch. It is imperative that they are done correctly from the outset.

One of the most important aspects of starting a business is making sure you are set up in the ***correct structure***. There are real advantages in choosing a structure best suited to the way you want to operate your business.

Setting up the most appropriate structure can protect your assets from future liabilities or for future generations whilst leaving you in control of the assets. Certain structures can be very tax efficient and can be used effectively to minimise capital gains tax on the sale of your business or investment assets.

In this reference guide we will explain the advantages and disadvantages of each of the following structures and their reporting obligations:

- Sole Trader
- Partnership
- Company
- Trust
- Joint Venture

This reference guide is intended as a guide only and it is very important that you seek professional advice to find out what the most appropriate structure is for your particular needs and financial situation.

Sole Trader

A sole trader is the simplest business structure owned and run by one individual.

Advantages

- Few legal requirements
- Inexpensive to set up
- Full control of the business and full benefits of profits
- Can keep all the after-tax gains if the business is sold
- Generally simple to cease

Disadvantages

- Unlimited liability so personally liable for all debts ie can lose personal assets if business goes into debt
- Access to finance is limited to own resources
- Debts and losses cannot be shared
- Business is tied to the trader so no continuity of existence if the trader dies

Reporting & Paying Income Tax

- You need to report the business income you earn (after expenses) on your personal tax return
- You pay the same tax as any other individual

Super Obligations

- Responsible for your own super arrangements and may be able to claim a deduction for personal super contributions you make
- If you have employees, you must make appropriate super contributions

Partnership

A partnership is an association of two or more people established to engage in a business enterprise with a view to a profit.

Advantages

- Inexpensive to set up
- More people to share workload, share losses and legal responsibilities

Disadvantages

- Must share profits
- Joint and severally liable meaning you and your partners are responsible for the debt even if you did not directly incur or cause the debt
- Can lose personal assets to settle debts of partnership
- Partnerships are governed by statute law, common law and partnership agreements but are less stringently regulated than companies and trusts
- Can sometimes get complicated to end a partnership – can be achieved voluntarily or by court order

Reporting & Paying Income Tax

- A partnership does not pay tax but you need to lodge an annual partnership tax return on behalf of the business
- The partnership tax return shows each partner's share of net partnership income
- As a partner you need to pay tax on your share of the partnership income

Super Obligations

- As a member of the partnership, you are responsible for your own super arrangements as you are not an employee of the business
- You may be able to claim a deduction for any personal super contributions
- If the business has employees, you must make appropriate super contributions

Company

A company is a legal entity which permits a group of people known as shareholders to run a business.

Advantages

- Far greater access to capital for the running of the business
- Pays tax on its own profits at a flat rate of tax which can be advantageous for businesses with high profit levels
- Shareholders are not liable for the debts of the business
- Increased asset protection

Disadvantages

- More expensive to establish
- More legal regulations as it is a distinct legal entity
- Tax reporting requirements are greater than for sole traders and partnerships
- Shareholders have little say in the running of the company
- Can only be terminated in accordance with Corporations Law

Reporting & Paying Income Tax

- Must lodge an annual Company Tax Return
- Company pays it own income tax on its net profit at a flat rate of 30%
- If you receive wages or directors fees from your company, you need to include them in your individual tax return

Super Obligations

- The company must make super contributions for any eligible workers it employs, including company directors

Trust

A trust is a relationship where the trustee carries on a business for the benefit of certain beneficiaries. There are several different types of trusts including discretionary, unit trust, hybrid trust.

Advantages

- Limited Liability particularly if the trustee is a company
- Trustee has power to decide how the profit will be distributed among beneficiaries
- A trust has perpetual existence and does not cease with the death of a beneficiary
- Increased asset protection
- Fewer formalities than running a company
- Substantial tax advantages
- Relatively simple to wind up a Trust

Disadvantages

- More expensive and potentially more technical to establish
- May be more expensive to complete the required tax and administrative paperwork each year
- Profits distributed to children under 18 may be taxed at higher rates

Reporting & Paying Income Tax

- Discretionary Trust does not pay tax
- Beneficiaries pay tax on their share of the trust's net income
- Trustee can decide each year which beneficiaries receive income
- Trusts can pay very high rates of tax on any income not distributed

Super Obligations

- Trust must make super contributions for any eligible workers it employs

Joint Venture

A joint venture is a business arrangement in which two or more parties agree to pool their resources usually for the purpose of accomplishing a specific task or project.

Advantages

- Simple to set up - usually only a joint venture agreement

Disadvantages

- Does not involve a general or ongoing relationship between the parties
- Complexity of the governing law will depend on the nature of the business they are involved in
- Members are joint and severally liable

Reporting & Paying Income Tax

- Not an individual legal entity so does not pay tax
- Joint venturers taxed on the joint venture income as they are on any other income they receive

Super Obligations

- If the business has employees, it must make appropriate super contributions