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Choosing the right business structure

Having the right structure can save your business time and money.

There are four commonly used business structures in Australia:

- Sole traders
- Partnerships
- Companies
- Trusts

There are real advantages in choosing the structure best suited to the way you want to operate your business. It is important you understand these advantages and responsibilities as they may affect:

- the way tax applies to your business
- protection of your assets
- your operating costs
- how other businesses deal with you.

You should use this information concerning business structures as a guide only.

Sole traders

If you operate your business as a sole trader, although you may decide to have employees, you trade, control and manage all aspects of your business.

Advantages

- There are few legal and tax formalities involved setting up the business
- The structure is inexpensive to set up
- You have full control of the business
- You receive the full benefit of profits made by the business
- You keep all the after-tax gains if the business is sold

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Things to consider

- You are legally responsible for all aspects of the business
- Debts and losses cannot be shared
- You can lose private assets such as your home, contents and vehicles if the business goes into debt

Reporting and paying income tax

- As a sole trader, you must report the business income you earn (after expenses) on your personal tax return, along with any other income you earn.
- You pay the same tax as any other individual and you are also entitled to the tax-free threshold (the first $18,200 you earn in an income year) if you're an Australian resident.

Paying super

- You are responsible for your own super arrangements and may be able to claim a deduction for personal super contributions you make. You must also make super contributions for any eligible workers you employ.

Partnerships

If you operate your business as a partnership, you're carrying on your business with one or more other people as partners and receiving your income jointly.

Advantages

- Partnerships are inexpensive to set up
- Greater access to finances from the resources of all partners
- There are more people to share the work load
- There are more people to share losses and legal responsibilities

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Things to consider

- You must share the profits with the other partners
- You and your partners are responsible for the debts of the partnership, even if you do not directly incur or cause the debt
- You can lose private assets such as your home, contents and vehicles to settle debts of the partnership

Reporting and paying income tax

- Although your business does not pay tax, you need to lodge an annual partnership income tax return on behalf of the business to show the total income earned and deductions claimed by the business. The tax return also shows each partner's share of net partnership income.
- As a partner, you must pay tax on your share of the partnership income (less expenses) you earn.
- Under a partnership, each partner is personally liable for the tax debts of the partnership.

Paying super

- As a member of the partnership, you're responsible for your own super arrangements as you're not an employee of the business. You may be able to claim a deduction for any personal super contributions you make, and the partnership must make super contributions for any eligible workers they employ.

<u>Companies</u>

If you operate your business as an incorporated company, the business is a distinct legal entity that is regulated by the Australian Securities & Investments Commission.

A company is a more complex business structure. Usually, the set-up and administrative costs for a company are higher than for other business structures.

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Advantages

- A company pays tax on its own profits
- Shareholders are not liable for the debts of the business
- Increased asset protection

Things to consider

- A company is more expensive to establish
- The tax reporting requirements for companies are far greater than for sole traders and partnerships
- Shareholders have little say in the running of the business. The business is run by the director/s

Reporting and paying income tax

- Your company must lodge an annual company tax return to report its income and deductions, and the income tax it is liable to pay. All companies must pay their own income tax.
- Your company pays tax on its net profit at a flat rate of 30%, which may be an advantage for businesses with high profit levels.

If you receive wages or director's fees from your company, you need to:

- include them in your individual tax return
- pay tax on them at the individuals tax rates.

Paying super

- Your company must make super contributions for any eligible workers it employs, including you as a company director.

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Trusts

If you operate your business as a trust, you are:

- a trustee
- responsible for holding property or income for the benefit of others (the beneficiaries).

The most common variety of trust is the discretionary trust. If you're the trustee of a discretionary trust, you have the power to decide how the profits will be distributed among the beneficiaries.

Advantages

- A trust has a limited liability to the extent of its assets
- A trust has perpetual existence and does not cease with the death of a beneficiary
- Increased asset protection

Things to consider

- A Trustee can be held personal responsible for the debts of a trust if they do the wrong thing or are negligent in fact or held to be negligent under the law
- If a company trustee, liability is limited to the company's asset base and unpaid capital unless a director is held personally liable
- If individual and joint trustees are held responsible for the activities of the trust, they may have potential liability to the extent of their net assets
- Profits distributed to children under 18 may be taxed at higher rates
- A trust with a company trustee with a sole director of the trustee company who owns no assets in their own right, provides a strong disincentive for any potential litigants

Reporting and paying income tax

- Your discretionary trust does not have to pay tax where the whole of the net trust income is distributed. Instead, the trust beneficiaries pay tax on their share of the trust's net income.
- As a trustee, you can use your discretion each year to decide which beneficiaries will receive income. Trusts can pay very high rates of tax on any profits that are not distributed.

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Paying super

- Your trust must make super contributions for any eligible workers it employs. This includes you if you are employed by the trust.

Other information

Australian Business Number (ABN) & GST:

You don't have to have an ABN, but it may help you to register for GST and other business tax obligations. If you choose not to have an ABN, other businesses can withhold 46.5% of payments to you.

You can have an ABN without being GST registered. You must register for GST once your turnover exceeds $75,000 per annum ($150,000 for Not-for-Profit organisations).