Choosing The Right Business Structure

There are many factors which will dictate the appropriate structure for your business. There are four basic types of business structures: sole trader, partnership, company and trust. These structures have different benefits and drawbacks, and suit different business purposes.

Look ahead five years
One of the important considerations when choosing a structure is to think about what the business will look like in five years' time. The structure that you set up at the start should be able to accommodate the business's growth over that time. We encourage you to ask the following questions to help determine the right structure for you:

- Why are you in business?
- What markets will you be selling to?
- How long do you intend to run the business?
- Will you have employees?
- Will you bring in a partner or do you have one already?
- Do you think the business will need equity investors?
- Do you want to keep the business quite small and work from home?

Changing your mind can be costly
Each structure has positives and negatives, and understanding which structure is the right one for you is important because it's very expensive to change structures once you're up and running. It's also hard to transfer the value of some assets, for example goodwill, from a sole trader structure to a partnership.

The sole trader
The sole trader structure is the simplest to operate, but under this structure the business owner is absolutely responsible for the business and its employees. In contrast, a company structure offers a degree of protection to the business owner because liability is limited to the amount of shares on issue.

It's also easier to sell a company than a sole trader's enterprise or partnership, but companies are more expensive to setup and to run than some other structures.

Partnerships
Partnerships also offer little protection – if one partner does something wrong, the other partner or partners may be accountable. But partnerships are still suitable in many circumstances.

Companies
A company structure offers particular tax benefits. Companies pay tax at a rate of 30 cents in the dollar, whereas sole traders who earn more than the top

marginal tax rate of $180,000 pay tax at 46.5 cents in the dollar. From a tax perspective, as a rule of thumb, it may make sense for a business to remain as a sole trader if taxable income is less than $80,000 – if tax is the only factor being considered.

Risky business

When deciding on the right structure, think about the needs of the business and its risk factors. If the company employs people who might be at risk because of their work, construction workers for example, a company structure might be suitable because of the insurances and indemnities that a company can take out.

A matter of trusts

Often when we set up company structures we use a combination of trusts and companies. The company gives you limited liabilities and a tax rate of 30 percent. Trusts give you flexibility over how income is distributed.

The difference between a company and a trust is that a company is an incorporated legal entity, whereas a trust is a legal relationship between the trustees and the beneficiaries of the trust. Trusts can be either fixed or discretionary – or even a combination of both. Under a fixed trust structure, the trust's distributions are fixed, under the discretionary structure distributions are at the discretion of the trustee.

Trusts allow a degree of flexibility about the way income is distributed. They also do not generally pay income tax, rather passing this obligation onto unit holders in the trust. You use a company and a trust together to create a business vehicle that provides for the separation and protection of assets. For example you might chose to put land and buildings of the business into a trust and the operations of the business into a company. Separating the assets allows the business owner to spread the business's risk across two vehicles, offering an even greater level of legal protection.

Extracting wealth

One reason you might choose a trust structure is because of capital gains tax (CGT) implications. If your company buys another business, and then disposes of this business, because there are no concessions for companies, full CGT would be payable at the highest marginal tax rate of 46.5 percent on disposal of this business. But you may qualify to get a CGT discount if you are in a trust, and there are some really great CGT concessions for small business available.

As business specialists, we see businesses all the time that are not appropriately structured, that are not extracting wealth to the full extent they can. You have to think about the tax implications of the structure you choose, about the wealth accumulation aspects of the business, about asset protection and wealth extraction when deciding the right structure for you.

Please contact Brad Huckel 02 4655 7263 if you would like to discuss your options for structuring, or re-structuring your business.