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Taxation Professionals

Starting up a business? We'll explain the different business structures

You are just starting up a business or are looking at starting up a business and are not sure what the best setup will be. Choosing the right setup is crucial; as it could save you tax in the long run.

4 different types of setups are as follows:

1. Sole Trader
2. Partnership
3. Company
4. Trust

<u>SoleTrader</u>

A sole trader is the simplest form of business structure. It is also relatively easy and inexpensive to start and maintain.

Many sole traders choose to trade under their own name - for example, John Smith - while others opt to register a business name which must done through ASIC. See http://www.asic.gov.au/for-business/registering-a-business-name/

There is no division between business assets or personal assets, which includes your share of any assets jointly owned with another person (such as your house or car). Your liability is unlimited which means that personal assets can be used to pay business debts.

Sole traders are taxed as individuals and pay income tax at personal tax rates. This means your business income is declared on your personal tax return along with any other assessable income (such as your salary or wages, interest, dividends).

Advantages of a Sole Trader

- Simple set up and operation.
- You retain complete control of your assets and business decisions.
- Fewer reporting requirements.
- Any losses incurred by your business activities, may be offset against other income earned (such as your investment income or wages). Subject to certain conditions.
- You are not considered an employee of your own business and are free of any obligation to pay payroll tax, superannuation contributions or workers' compensation on income your draw from the business.
- Relatively easy to change your legal structure if the business grows, or if you wish to wind things up.

Disadvantages of a Sole Trader

- Unlimited liability - all your personal assets are at risk if things go wrong.
- Little opportunity for tax planning - you can't split business profits or losses made with family members and you are personally liable to pay tax on all the income derived.

<u>Partnership</u>

A Partnership is two or more people jointly in business with a view of making a profit. The rules of registration, etc are exactly the same as a sole trader, the only difference being that there is more than one person involved.

Advantages of a Partnership

- Simple setup and operation
- More people to help with the workload
- Better position for financing purposes
- More than one person sharing the legal responsibility

Disadvantages of a Partnership

- Both partners will be liable for any debts, even if it was only incurred by one of the partners
- Unlimited liability - all your personal assets are at risk if something goes wrong

Company
A Company is a separate legal entity from its owners and needs to be registered with the Australian Securities and Investment Commission. The setup costs of a Company are much higher than the registration of a sole trader or partnership, and a Company must lodge its own return separate to its owners.

Advantages of a Company

- Flat rate of 28.5% tax
- Greater access to capital
- Limited Liability of Directors, including asset protection of all officeholders of the company

Disadvantages of a Company

- More Expensive to Setup
- Greater reporting obligations

Trust
Finally, the last structure is a Trust, which is also a separate legal entity. The most commonly used trust is the Discretionary (Family Trust). The trust allows a greater flow of income to many beneficiaries in order to pay less tax. The trustee of the trust controls the trust and determines who receives its income. The trust does not pay tax in itself, as it is distributed out to its members (also known as beneficiaries).

Advantages of a Trust

- Limited liability - if the Trustee is a company
- Greater savings in tax, especially for individuals with many children or kids over 18
- Increased asset protection – your personal assets are protected

Disadvantages of a Trust

- More expensive to setup
- Greater reporting obligations