Business Structures

Sole trader

One person owns the business and may operate under a business name, which they must register, and they may employ others but not themselves.

A sole trader has personal ownership and control over the business assets. Downside is the lack of separation between personal assets and the business assets of the owner. To commence business all that is required is an Australian Business Number (ABN) and depending on the service offered, and the level of turnover, to register for GST.

The sole trader is personally and solely liable for any unpaid debts that the business may incur, meaning that if necessary, personal assets such as a car or home may be sold to meet any shortfall. However on the plus side, all profits generated go directly to the sole trader and they make their own business decisions.

Partnership

A partnership is a relationship that exists between two or more people who carry on a business for the joint purpose of making a profit.

A partnership can be formed orally or a partnership deed can be drawn up, which governs the rights and obligations of each partner. In South Australia partnerships also abide by the provisions of the Partnership Act 1891 (SA). The partnership needs to obtain an Australian Business Number (ABN) and depending on the service offered, and the level of turnover, to register for GST.

Assets within the partnership are owned by the individuals as tenants in common. Therefore all personal assets of the partners are at risk, should the partners be sued or if the partnership is unable to meet debts incurred. Should lenders seek to recoup debts they will seek their money from the partner with the most conveniently available funds and not in proportion to partnership share.

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Small proprietary company

A proprietary company is a legal entity that is separate to the individuals who own and manage the company. It therefore has its own assets and liabilities and can make profits and losses separately from its shareholders.

Upon setting up of a company the company name, Directors, members (shareholders) and share structure are registered with the Australian Securities and Investments Commission ('ASIC'), a government regulatory body that administers the conduct of companies in Australia. The company then registers for an ABN, GST if trading, and PAYG Withholding and WorkCover if employing people.

Annually fully reconciled Financial Accounts must be prepared, a company tax return lodged with the ATO and an annual fee paid to ASIC of $243. Due to the compliance responsibilities accounting fees will normally start at $1,500 per year for this work and companies are the most expensive form of entity to set up and maintain. Directors have a duty to act in the best interest of shareholders and there are fines and prosecution if there is a failure to comply with the legislation.

However, important advantages of a small proprietary company is that liability for the companies debts is limited to the company share capital, ease of transferring ownership by selling shares, favourable tax rates and access to a wider capital and skills base. Unless Directors fail in their duties, their personal assets are protected should the company business fail, Directors do become personally liable if they allow the company to trade whilst insolvent, and if they do not meet certain Tax Lodgement deadlines.

Discretionary family trust

A discretionary family trust is not a separate legal entity, therefore it cannot sue or be sued and the trust itself cannot incur debts and liabilities. A trust is established via a deed of settlement and the important people in a trust are: the appointor, who has the ability to hire and fire the trustee; the trustee/s who are the legal custodians of the trust property and must hold property for the benefit of the nominated beneficiaries; and the beneficiaries for whose benefit the trust property is held.

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A discretionary family trust is best chosen as the structure for owning and operating a business, when there are multiple family members, (excluding minors), either involved in running the business or that can receive distribution of income to take advantage of lower income tax thresholds of individuals.

The powers of a trustee are restricted by the trust deed and the trustee has a duty to always act in the best interests of the beneficiaries. The trustee is fully liable for the debts of the trust but can be indemnified from the assets of the trust for the settlement of those debts. If the debts exceed the assets then the trustee is personally liable. If a business is going to be conducted by a trust then it is advisable to have a Company as the trustee.

Trust have significant advantages as entities for which to own investments in and also have advantages for estate planning purposes.

Income tax rate of each entity and responsibility for paying the tax

Sole Trader

The rate of tax for a sole trader is at their individual tax rate, this includes a tax free threshold of $18,200. If the income from this business is not their only source of income the business profit will be taxable at the tax rate at which the business income is received, over and above their other income. Tax rates for the 2014 Financial Year are as follows:

Taxable income	Tax on this income*
0 – $18,200	Nil
$18,201 – $37,000	19c for each $1 over $18,200
$37,001 – $80,000	$3,572 plus 32.5c for each $1 over $37,000
$80,001 – $180,000	$17,547 plus 37c for each $1 over $80,000
$180,001 and over	$54,547 plus 45c for each $1 over $180,000

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Partnership

A partnership is not an entity in its own right therefore each partner of the business pays tax at their individual rate. A tax return is lodged for the purpose of ascertaining and allocating each partner's share of the profit or loss. Partnership losses can be allocated to partners and, if they pass certain tests, the loss can be applied against their other income for that financial year.

Profit must be distributed to each partner in the proportion of their partnership share; there is no discretion to direct income to partners with lower incomes and therefore lower tax rates. If allowed by the partnership deed, or agreed, a partner's salary can be paid to partners who have a meaningful role in the business of the partnership to direct further income to them and they will pay tax on this partner's salary at the individual tax rates.

Company Tax

A company pays tax on its profits at a flat 30%.

Income can be paid from a company in two ways: as wages to employees or working Directors, or as a dividend to shareholder/s. A dividend can be franked and an imputation credit for tax already paid by the company, can be attached with the dividend. Wages, dividends and imputation credits are declared as assessable income in the tax return of the recipient.

A company is the only entity that can retain profits. There is some ability to split after tax profit, such as dividends, by either having different owners for the different classes of shares or having the shares owned by a discretionary trust.

With regards to taxation of Companies there are a few very important issues to be aware of:

1. If shareholders borrow money from a company they must have a loan agreement with the company and pay interest on the loan. The term of the loan is dependent on the security offered. (Division 7A ITAA)

2. Capital Gains made by a company attract no CGT discount, even if they are held over 12 months. (ITAA s 102-5; Division 115)

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3. Any private benefit provided to an employee, this includes the Company Director, or their associates; including company assets used by any company employee or their associates for non-business purposes are subject to Fringe Benefits Tax on the value of that benefit

4. If the company is a personal services company, that is a company whose profits are generated solely by the principal, all profits must be distributed in wages, superannuation or dividends to the principal person. Therefore profits cannot be retained and a lower company tax rate utilised. (Part 2-42 ITAA).

5. Losses are trapped within the company, (individual shareholders cannot benefit), however, losses may be transferred from one Australian resident company within a group to another provided 100% common ownership exists. (Division 170 ITAA)

6. All salaries and benefits of employees, including Directors, are subject to WorkCover and form part of the calculation of the total remuneration for payroll tax purposes.

Discretionary Family Trust

Has to minute the distribution of all of its income before 30 June each year.

Undistributed profits are taxed at the highest individual tax rate. Income can only be distributed to beneficiaries of the trust.

The trustee has full discretion over the distribution of the income so this is the best vehicle for income splitting. The downside is that no income can be retained unless the top tax rate is paid. Also losses are quarantined in the trust to be offset against future profits of the trust and cannot be distributed.

All CGT and small business discounts are available to the beneficiaries.

Beneficiaries of the trust cannot be changed or the trust will be resettled which will lead to the deeming of capital gains tax profits on unrealised gains.

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