Guide to COMMON BUSINESS STRUCTURES

When starting a business there are a multitude of business structures to choose from. Getting it right can be difficult, and it is important to choose a structure that will be right for you in the long term.

The factors to take into account when choosing a structure include:

1. Risk profile – if you are in a higher risk industry, a company will provide a higher level of protection than if you were operating as a sole trader;
2. Who is involved – if there are multiple co-owners, generally a company and/or unit trust structure is suitable, as it is flexible, facilitates bringing in new owners and assists with easier exits;
3. Future plans – if you are planning on selling the business in the future, certain structures are more attractive to potential buyers than others;
4. Tax – each structure is taxed differently, and it may be that one structure is more tax effective for you than another; and
5. Compliance – the more complicated the structure, the more compliance and ongoing costs will be incurred.

THREE COMMON STRUCTURES

The three most common structures are:

1. Sole Trader;
2. Company; or
3. Trust (generally with a company as the trustee).

There are other structures, such as a trust with an individual trustee or a partnership, however the above are most common.

SOLE TRADER

A sole trader structure is inexpensive, simple to set up and it is less regulated in comparison to other business structures. Essentially, all you need to do is register for an ABN. The primary drawback of this model is that it does not protect you from personal liability in the event a client, customer or third party sues you. Even if you have professional indemnity insurance, there are always exclusions and invalidations.

You are also personally liable for all of your business debts, whereas in a company structure you are only liable in certain circumstances. The profits of your business are taxed at the personal tax rates, which may be higher or lower than the company tax rate depending on how much profit you generate.

COMPANY

A company structure is slightly more complex and regulated, with set up and ongoing costs higher than a sole trader structure.

Despite this, there are many benefits to using a company to conduct your business. The company tax rate is significantly lower than the highest personal tax rate, so your profits may be taxed at a lower rate than if you were to use another structure.

Companies also provide a high level of protection for shareholders and directors (you) – you've probably seen the letters "Ltd" or "Limited" at the end of a company name before. This means that liability of shareholders in the company is limited to the amount unpaid on their shares (which is generally nil). So if the company becomes insolvent or is sued, although the company could lose all of its assets, your personal assets (such as your home) will usually be safe.

In some cases the directors of companies may be required to provide personal guarantees to landlords, suppliers, banks and lenders to the company, which ultimately defeats the "limited liability" aspect of having a company. Giving a personal guarantee means that if the company doesn't perform its obligations, the person who you gave the guarantee to, can come after you to do what the company was supposed to do (usually pay money). Directors also have duties under the Corporations Act and a breach of those duties could result in personal liability. A company structure also looks more professional, depending on your industry.

TRUST (WITH COMPANY TRUSTEE)

A trust is simply a relationship where a person or entity ("trustee") conducts the business for the benefit of other people (the "beneficiaries"). If set up the right way, a trust can be more tax effective than a company structure alone. In a discretionary trust, the trustee can determine how the funds of the trust are to be distributed amongst the beneficiaries, noting the beneficiaries pay tax at their personal tax rates.

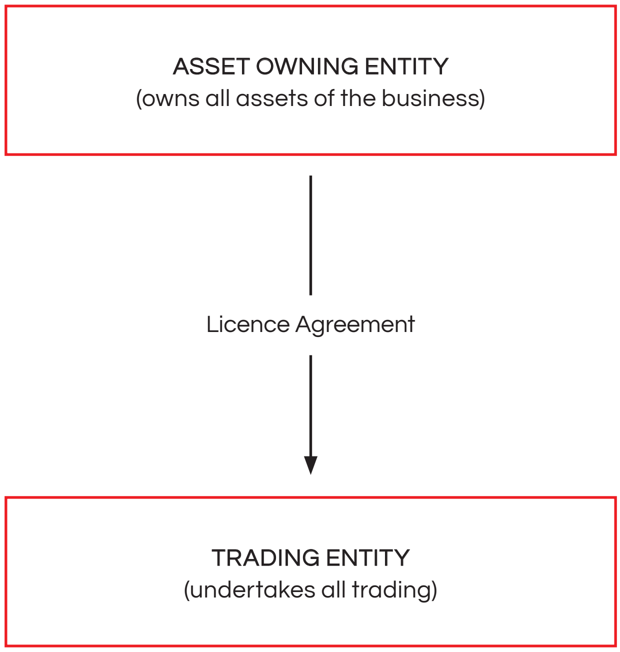
For example:

- you could have your partner, children, other relatives and yourself as beneficiaries;
- you could control the company trustee by being its directors;
- each year or quarter, you could decide how you want to distribute the income of the trust amongst the beneficiaries in way that is most tax effective for you. Say that you had already earned a significant amount this year and were paying tax at the highest rate, but your partner had not earned a lot and was paying tax at a lower rate than you, you could distribute more income to that person and less or none to yourself.

Ultimately a trust gives you the greatest flexibility and ability to distribute income tax effectively amongst a family group.

The trustee of a trust can be an individual or a company. If the trustee is an individual, they can be personally liable for the losses incurred by the trust (so essentially you have the same risks as with a sole trader structure). The benefit of having a company act as trustee is that, provided the company has no assets, the company has nothing to lose in the event it is liable for the losses of the trust. By using a company you essentially add a layer of asset protection (see the benefits of using a company structure above).

There are several different types of trusts to choose from, with the most common being a discretionary trust, (or family trust) as that gives you the flexibility to distribute the income as you wish. Unit trusts are more commonly used by unrelated investors.



ASSET PROTECTION

A common asset protection strategy is to hold the assets of the business in one company, and trade (i.e. enter into contracts, employ staff and otherwise conduct the business) using another company. The asset owning entity licences the trading entity the right to use the assets in the conduct of the business, however the licence can be terminated at any time by the asset owning entity. The purpose of this arrangement is to shield the assets, (such as the business name, software, plant and equipment etc.) from being exposed in the event a claim is made against the trading entity. Depending on the assets being licenced, the asset owning entity may need to register a security interest over the assets licenced on the Personal Property Securities Register in order to protect itself in the event the trading entity becomes insolvent.

KEY TAKEAWAY

There is no “one size fits all” structure, and the best structure for you will depend on your particular circumstances. If you are in the process of setting up your business, or if you are looking at a restructure, feel free to contact us to discuss which option will be best for you. Beck Legal provides advice on all aspects of structuring and asset protection at both a corporate and personal level.