COOPER GRACE WARD
LAWYERS

Selecting an appropriate business structure

What are the options?

Key points

- The choice of business structure is personal: there is no one-size fits all structure
- Each structure has its own advantages and disadvantages
- Choosing a structure now that will meet your needs in the future will save you time and money later

Available options

1. In most cases there are four alternative structures available:

   (a) sole trader/partnership;

   (b) company;

   (c) discretionary trust;

   (d) unit trust.

2. Each structure has its own advantages and disadvantages, which are set out below. The right structure for you will depend on which of the features below are important to you both now and in the future.

Partnership/sole trader

Features

3. The owners of the business are responsible for the payment of all income tax on the profits of the business.

4. The owners are fully responsible for all debts of the business. This means that the owner's assets can be exposed to claims from business creditors.

5. A partnership is governed to some extent by the *Partnership Act* in Queensland but is not otherwise subject to specific government regulation or control.

Advantages and disadvantages of partnerships

Advantages	*Disadvantages*
Simplicity	Inflexible
No tax difficulties in distributing retained earnings.	Partners have full personal exposure to liabilities of business (including amounts owed to creditors and negligence, work place health and safety or similar actions).
Lower setup and ongoing administration expenses.	
Owners' 'salaries' do not attract payroll tax.	Full duty under the *Duties Act 2001* (Qld) payable on gross assets on any change in partnership.

Advantages	*Disadvantages*
Owners are not ‘employees’ for FBT and SGC purposes.	Partners in a partnership are jointly and severally liable. This means that *each* partner is liable for the debts of the partnership
Tax losses can be offset against other income of partners/sole trader.	
Owners get full benefit of CGT goodwill and small business rollover concessions if business is sold.	

Discretionary trusts

Features

6. The trust is not a separate legal entity. A trustee (either individuals or a company) must be appointed to hold legal title to the trust assets.

7. Trusts are subject to the *Trusts Act* in Queensland.

8. If a corporate trustee is appointed, then the operations of the trust will also be subject to the *Corporations Act*.

9. In most cases the beneficiaries who receive or are entitled to the income of the business are taxed on their share of income. However, in some circumstance the trustee may be liable for tax on income not distributed to beneficiaries.

10. The beneficiaries of the trust will not be liable for debts of the trust unless they give guarantees. The trustee is personally liable for debts of the trust but has a right of indemnity against the trust assets. That right of indemnity does not extend to the beneficiaries except in special circumstances.

11. Where a corporate trustee is used the directors of the corporate trustee may be personally liable if they breach the provisions of the *Corporations Act,* the tax laws or other statutes and regulations (e.g. *Workplace Health & Safety Act*).

Advantages and disadvantages of discretionary trusts

Advantages	*Disadvantages*
A discretionary trust provides maximum flexibility. The trustee can generally choose who or which entity to distribute the income or capital of the trust to.	The initial set up costs are slightly higher than for a company or partnership.
Each beneficiary is taxed on distributions they receive at their own marginal tax rate.	Additional tax issues can arise if distributions are not paid to beneficiaries or distributions are then loaned back to the trust by a beneficiary. These need to be managed carefully.
Provides a measure of limited liability particularly against large damages claims for negligence, product liability etc..	No ability to bring in multiple owners with separate and distinct ownership interests. Duty may be payable on any change in beneficiaries. Duty is calculated on the gross value of the assets of the trust.

Advantages	*Disadvantages*
If capital gains are distributed to beneficiaries who are individuals, the beneficiaries can access the 50% general CGT discount.	If the trustee wants to retain profits in the trust rather than distribute them, tax is generally payable at the highest marginal tax rate.
Can access the CGT small business concessions with careful planning (assuming conditions are met).	Tax losses are locked into trust and will be subject to loss trust provisions.
If salaries are paid to directors etc. then 100% deduction can be claimed for superannuation contributions (provided a corporate trustee is used).	If salaries are paid to owners these will be included in gross payroll for payroll tax and SGC purposes.
Relatively easy to wind up.	May need to make a family trust election to use imputation credits on franked dividends received by the trust or to be able to utilise losses in future.

Company

Features

12. The company is a separate legal entity. The investors are usually the shareholders in the company and also directors.

13. Companies are subject to the *Corporations Act* and are regulated by the ASIC.

14. The company pays tax on all its income at a maximum rate of 30 cents in the dollar. Trading companies are taxed at 25 cents in the dollar subject to certain conditions being satisfied.

15. Under the imputation system any dividends declared out of after-tax income are described as fully franked and carry with them a franking credit.

    The effect of the imputation system is that if the company pays tax at 25 cents in the dollar, shareholders whose marginal rate of tax is 25% or less will not pay any further tax on receipt of fully franked dividends. Shareholders whose marginal rate of tax is higher than 25% will only pay the incremental amount by which their marginal tax rate exceeds 25%.

16. Shareholders are generally not liable for the debts of the company unless they provide guarantees.

17. Directors are not generally liable for debts of the company unless they provide guarantees but may be liable in certain circumstances prescribed under the *Corporations Act* and various other statutes.

18. A company may not suitable for acquisition of assets which appreciate in value (such as an investment property) because, for CGT purposes, the company does not get the benefit of the 50% general CGT discount.

19. Financiers and prospective investors are more comfortable with a company structure than with trusts.

20. If using a company, careful consideration should be given to who is the shareholder. For example:

    (a) having an individual shareholder is cheaper and simpler but gives limited tax planning ability and asset protection;

    (b) having a discretionary trust shareholder will provide more flexibility and asset protection but increases the initial set up cost.

Advantages and disadvantages of companies

Advantages	*Disadvantages*
Flat tax rate	Lack of flexibility
Fully franked dividends allow shareholders to get a credit for the tax already paid by the company on any dividends. The shareholders only pay top-up tax on dividends.	Tax losses are locked in the company (except that losses may be transferred within wholly owned group companies).
No duty is payable on the transfer of shares in the company (provided the company is not a landholder under the *Duties Act*)	Salaries paid to directors, shareholders and associates will be subject to payroll tax.
Directors are employees and superannuation contributions paid by company are fully deductible.	Set up costs are higher than a partnership but usually less than a trust.
Can create separate share classes with discretionary dividend rights to provide some flexibility in distributing dividends.	Ongoing administration costs are usually higher than a partnership but the same as a trust.
Company structure facilitates introduction of future equity capital.	The procedures for winding up of the company are complex and expensive and may involve tax liability.
Will be eligible for CGT small business replacement rollover concession.	Loans to directors/ shareholders may be taxed as unfranked dividends (s.108 and Division 7A).
	Benefits provided to directors may be subject to FBT.
	Will be difficult to access the CGT small business retirement rollover concession.

Unit trusts

Features

21. Unit trusts are similar to companies in that the unitholders have a defined interest in the unit trust.

22. Unit trusts are suitable for investments structures involving multiple participants, as they are similar to companies in that the unitholders have a defined interest in the unit trust.

23. A unit trust is less suitable for businesses because taxation issues can arise when untaxed profits (such as amounts not taxed under certain CGT small business concessions) are distributed to the unitholders (CGT Event E4).

24. Unit trusts can be more beneficial than companies where assets which appreciate in value are to be acquired (such as an investment property) because the unitholders may be able to access the 50% general CGT discount where the unit trust makes a capital can if the unit trust distributes the capital gain.

25. If using a unit trust, careful consideration should be given to who is the unitholder. For example:

    (a) having an individual unitholder is cheaper and simpler but gives limited tax planning ability and asset protection;

    (b) having a discretionary trust unitholder will provide more flexibility and asset protection but increases the initial set up cost.

26. Care must be taken when:

(a) issuing initial units;

(b) issuing additional units; and

(c) dealing with shares in trustee company,

to ensure that duty under the *Duties Act* is not incurred.

This will be achieved if only a nominal number of units are issued initially and, with all allotments of additional units, the proportional unitholding of each unitholder is maintained.

27. If the unit trust incurs losses it may be difficult to retain the tax benefit of these losses if 50% or more of the units are held by discretionary trusts.

Advantages and disadvantages of unit trusts

Advantages	*Disadvantages*
Each unitholder that is a company or an individual is taxed on distributions they receive at their own marginal tax rate. If the unitholder is a discretionary trust, each beneficiary of the discretionary trust is taxed on distributions they receive at their own marginal tax rate.	The initial set up costs are slightly higher than for a company or partnership.
Provides a measure of limited liability particularly against large damages claims for negligence, product liability etc..	Additional tax issues can arise if distributions are not paid to unitholders or distributions are then loaned back to the trust by a unitholder. These need to be managed carefully.
Unitholders that are individuals or discretionary trusts can access the 50% general CGT discount (provided that any capital gain by a unitholder that is a discretionary trust is distributed to individual beneficiaries).	Duty may be payable on any change in unitholders. Duty is calculated on the gross value of the assets of the trust.
Unitholder can access the CGT small business concessions with careful planning (assuming conditions are met).	If the trustee wants to retain profits in the trust rather than distribute them, tax is generally payable at the highest marginal tax rate.
If salaries are paid to directors etc. then 100% deduction can be claimed for superannuation contributions (provided a corporate trustee is used).	Tax losses are locked into trust and will be subject to loss trust provisions.
Relatively easy to wind up.	If salaries are paid to owners these will be included in gross payroll for payroll tax and SGC purposes.
Ability to bring in multiple owners (unitholders) with separate and distinct ownership interests (units).	Will generally need to satisfy the requirements of a fixed trust to be able to utilise losses in future.