Starting your business

Choosing the right structure

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Getting started

So, you have an idea for a new business, you've prepared a business plan, and now you're ready to take the next steps.

From here, your first step to turning your business idea into reality is choosing a business structure that will form the future foundation of your business.

When you think about a business structure, there are a number of considerations including legal, tax and financial. We've commented on the legal and some of (but not all of) the tax considerations –we'll leave you to consider your financial and tax considerations based on your specific requirements.

Here's what we have put together for you.

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Having the right **structure** can save your business time and money.

There are four main types of business structures commonly used by small to medium-sized businesses, and each carries with it different features.

SOLE TRADER

PARTNERSHIP

TRUST

COMPANY

We have looked at each structure and set out a high review of the strengths, weaknesses, opportunities and threats, for you to consider.

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Sole trader

As a sole trader you will personally manage all aspects of the business. Many sole traders choose to trade under their own name, while others choose to register a business name.

Sole traders have included small business owners that provide personal and / or professional services such as doctors, accountants, hairdressers and even lawyers.

STRENGTHS	WEAKNESSES
You can get started quickly	Your ability to fund your business is usually limited to your own resources
There are generally no reporting requirements for the business (but of course you still need to do your tax!)	You are personally and legally responsible for all aspects of the business
You have full control of the business, in fact, you are the business!	There is limited opportunity for tax planning – you can't share profits or losses and you are liable to pay tax on all the income
You receive the profits made by the business – as a sole trader you are taxed as an individual and pay income tax at personal tax rates. Your personal tax file number is used for your business	

OPPORTUNITIES	THREATS
Relatively easy to change the structure if your business grows	You have unlimited liability - all your personal assets are at risk if the business goes into debt or otherwise incurs a liability - basically, you're on the hook!

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Partnerships

A partnership involves two or more people going into business together. The basic intention of a partnership is for the partners to share in the profits and losses proportionally to their partnership interests.

A partnership is not a separate legal entity and does not pay income tax on income earned. Each partner pays tax on their share of net partnership income and will lodge their own income tax returns.

The partnership will also complete a tax return showing partnership's income and deductions, and how profit or loss was shared – the partnership will have its own tax file number.

Partnerships have typically been used in accounting, law, advertising and other professional services.

STRENGTHS	WEAKNESSES	OPPORTUNITIES	THREATS
Relatively straight forward (but less so than a sole trader) to set up - although you will need a partnership deed	Potential disputes over profit sharing, administrative control and business direction can arise and be complex to manage particularly as the partnership grows	Income splitting between partners opens up tax planning options	A partner's personal assets are at risk if the partnership goes into debt or otherwise incurs a liability – partners have unlimited liability to the partnership
There are generally no reporting requirements (but of course you still need to do your tax!)	Whilst the position is a little more complex, generally speaking, partners are jointly liable for the debts and other liabilities of the partnership, whether or not they were directly responsible for them		
Aside from the partnership deed, it is still relatively inexpensive to set up.	It can be complicated to change from a partnership to another business structure (such as a company)		
There is usually improved access to finance because there is more than one partner involved			
More people to share the workload and contribute skills and knowledge to the business			
More people to share the losses and responsibilities of the business			

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Companies

A company is a separate legal entity that will hold assets in its own name, conduct business in its own right, and can sue and be sued in its own name.

A company is separate from its share holders (who own the company) and its directors (who control the company); these features give the company certain unique qualities that make it very different from a sole trader or a partnership. A company will have its own Tax File Number / Australian Business Number.

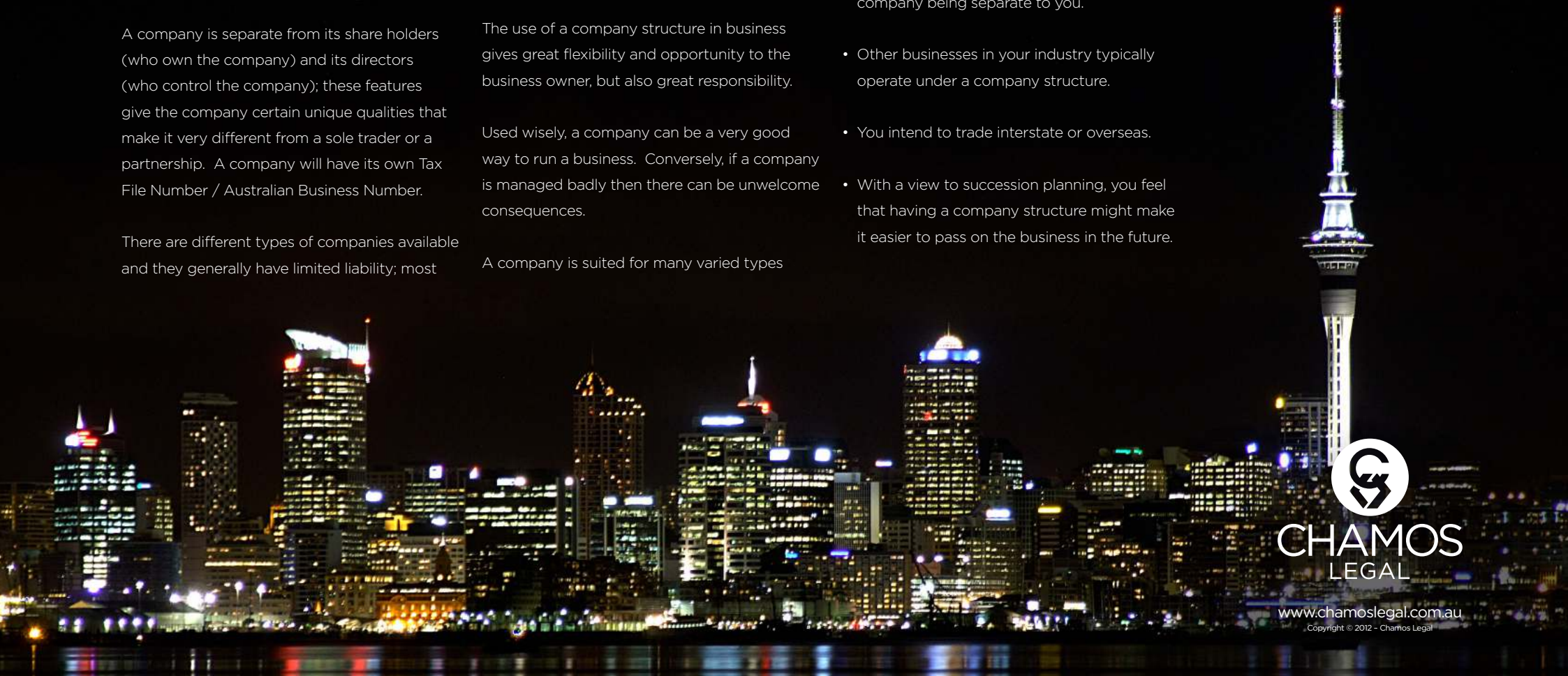
There are different types of companies available and they generally have limited liability; most are limited by the amount of their share capital but some can also be limited by guarantee. In normal circumstances, you would probably be looking to establish a company limited by shares.

The use of a company structure in business gives great flexibility and opportunity to the business owner, but also great responsibility.

Used wisely, a company can be a very good way to run a business. Conversely, if a company is managed badly then there can be unwelcome consequences.

A company is suited for many varied types of businesses, from personal, professional to trading and manufacturing. Reasons why you might choose to set up a company can include:

- You might be attracted to the idea of the company being separate to you.
- Other businesses in your industry typically operate under a company structure.
- You intend to trade interstate or overseas.
- With a view to succession planning, you feel that having a company structure might make it easier to pass on the business in the future.



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Companies (continued)

STRENGTHS	WEAKNESSES	OPPORTUNITIES	THREATS
Depending on the type of company involved a company will usually have limited liability	There are some initial set up and registration expenses and as well as on-going registration fees	Easy to sell and pass on ownership	Directors and other officers of the company owe special duties and responsibilities to the company. Among other duties, they must always act in the best interests of the company.
In normal circumstances, the personal assets of a director of a company won't be at risk to pay company liabilities – but this will not always be the case, see "threats"	Depending on certain criteria, there may be reporting requirements for the business. For typical small businesses though, the reporting requirements are usually minimal	Easy to share ownership of the company	Directors and other officers can be personally liable for their actions, for example, where they allow a company to trade whilst it is unable to pay its debts. There are others.
A company can exist forever		Easy to separate ownership from management of the company	If a Director is found to be personally liable for the conduct of the company then their personal assets are at risk.
Subject to legal requirements being satisfied, a business owner can bring investors in without necessarily losing control		The company can employ people, and as a director you can also be paid a wage/salary as an employee / director	
Subject to legal requirements being satisfied, there is improved scope and capacity to raise capital (whether by bringing other investors into the business or by borrowing money)		Profits are distributed to shareholders by way of distributions	
		Tax planning options are available	

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Trusts

A 'Trustee' (either an individual or a company) will carry on the business and hold property and income for the benefit of others (known as 'beneficiaries'). These arrangements are usually documented under a deed and there are various types of trust deeds available depending on the specific needs for the business. We call this arrangement a 'Trust' and the document that evidences the arrangement a 'Trust Deed'. The use of a Trust (either with or without a company acting as trustee) can give a business owner great flexibility and opportunity. But the use of a Trust also carries with it great responsibility – Trusts must be handled with care if they are to be effective for your business!

One of the key motivators involving the use of trusts is tax and financial planning. There are a number of businesses that could conceivably be operated through a trust. Some more common examples include property and project development companies but there are others. A decision to use a trust would involve close consultation with your accountant and tax adviser.

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Trusts (continued)

STRENGTHS	WEAKNESSES
If the trustee is a company, it will also have the benefit of limited liability (see "company") The trust won't necessarily dissolve if a beneficiary of the trust dies The trust can exist for an extended period of time (usually up to about 80 years)	There are some initial set up expenses associated with establishing the trust There are complex tax and accounting implications that will require the involvement of an accountant

OPPORTUNITIES	THREATS
Depending on the nature of the trust and the prevailing tax laws, there can be flexible asset and income distribution arrangements	The trustee is personally liable for the debts of the trust and will have to meet the shortfall if the assets of the trust aren't enough to cover a debt or liability

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Make the call

- What type of business will you be running?
- Who else will be involved and what role are they playing? Investors, business partners etc.?
- How much do you plan for it to grow over time?
- What are the risks in your industry? What are your competitors doing?
- Do you need to keep your assets separate from the business?
- What are your personal circumstances at the moment?

The answers to these questions (and more!) will help you make an informed decision about what the right business structure is for you.

Changing your business structure in the future can sometimes involve additional time and cost, so it makes good sense to take the time at the start to get the fundamentals right.

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About Chamos Legal

Chamos Legal is committed to empowering you with tips and general legal information about relevant topics that can assist you in your business.

If you would like specific assistance in relation to your business, we would be happy to hear from you.

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