



## A GUIDE FOR ESTABLISHING AND STRUCTURING A BUSINESS

Setting up a business is an exciting time for any entrepreneur, however it can also be a daunting task if done without a well-thought-out business plan in place. One of the most important issues to determine early on is what the structure of the business should be.

There are many factors that need to be addressed and considered to be able to determine the most appropriate business structure not only just for the owners but also for the business itself as well as any potential clients or business partners.

When the startup is correctly structured from the outset, it will reduce the need for any restructuring in the future, which can be expensive and create tax and transfer duty issues.

In Australia, there are four common ways to structure a new business startup, being:

- Sole Trader;
- Partnership;
- Company; and
- Trust.

### 1. **Sole Trader**

The sole trader structure is the most straightforward and simplest structure to set-up. Essentially, the sole trader will commence a business under their own name or a business name which they personally have reserved. This means there is no differentiation between the individual and the business itself.

Whilst this structure is low cost and means that the sole trader has 100% control of the business, there are also some drawbacks. The owner will be personally liable for any legal and financial matters that may arise from operating the business and his or her personal assets may therefore be at risk if things should go wrong with the business.

In terms of tax requirements, a sole trader is not required to register for GST until the business earns more than \$75,000 per annum. The income and expenses of the business is

simply added to any other income derived by the individual and included in that individual's tax return.

## **2. Partnership**

A Partnership is business based on an agreement between 2 or more persons (up to 20, with some exceptions) to commence a partnership with a view of running a business to make a profit. There are two types of Partnerships – General and Limited.

General Partnerships involve all partners participating in the day to day management of the business. A Limited Partnership has at least one general partner (controls the day to day operation and is also liable for business debts) and passive partners (limited partners).

A Partnership is reasonably straightforward and inexpensive to set up. Generally, a Partnership Agreement will need to be drafted and signed by the Partners. The Partners have full control of the business but also assume personal liability (usually on a joint and several basis) for any legal and financial matters.

The Partnership Agreement provides for the obligations of partners, financial contributions and responsibilities, profit sharing, termination and the general rights of the partners. The Agreement should not be taken lightly as it is an important document that acts as the “rulebook” of the Partnership and provides for what needs to be done in the event of any disputes between the partners.

While the Partnership will register for income tax purposes, and lodge tax returns, it is the partners themselves who will be liable for the tax on that income.

## **3. Company**

Setting up a Company involves the creation of separate legal entity, with shareholders and directors, that is registered with and monitored by the Australian Securities Investment Commission (ASIC). The incorporation of a company is straight forward and relatively inexpensive. It is also recommended that a Shareholders Agreement is executed where there is more than one shareholder.

Being a separate legal entity means that the Company itself is seen as its own entity and generally, the directors do not bear any personal legal or financial responsibilities in relation to matters of the Company. The directors do not take a share in profits and instead draw down a salary (with superannuation) from the Company. Profits are distributed to shareholders as dividends.

In terms of tax obligations, income tax is paid at the company tax rate which at the date of publication is either 27.5% or 30%, depending on the turnover of the company. Dividends can be distributed to shareholders with or without a credit for the tax paid by the Company (imputation credits).

## **4. Trusts**

Trusts are often perceived as difficult and complicated structures to set-up, however with the correct business plan and professional advice creating a Trust can also be straightforward.

A Trust is established by a Trust Deed and simply put, it is created when the owner of property (Settlor/Grantor) legally transfers the property to a third party (Trustee) who then manages the asset for the benefit of another (Beneficiary).

Trusts can hold assets, invest, enter financial transactions and even operate businesses. A Trust can provide more flexibility with how profits are distributed, as well as limitations to liability and asset protection.

Generally, a trust will pay tax on its income, at the highest individual tax rate, unless that income is distributed to its beneficiaries. It is therefore common practice for a trust to distribute 100% of its income in each year of income. In some circumstances, this income (after payment of tax) may be lent back to the trust by some or all of the beneficiaries. This need to distribute all of the income each year can be a disadvantage.

There are a variety of trusts that can be used but the most common are the family discretionary trust and a unit trust. The former will generally have a large number of beneficiaries, none of whom with fixed entitlements, while the latter usually has fewer beneficiaries, each of whom have fixed entitlements to income and capital.

Setting up a business should be done with a solid business plan based on an appropriate business structure. Murfett Legal can assist potential new business owners or directors at all stages in the creation of a new business from devising a solid business plan, assisting with the creation and necessary registrations of the business structures to ongoing business advisory support.

Should you wish to learn more about commencing a business or would like to discuss any other commercial matter, please contact one of our team at Murfett Legal.

The above is a summary for general information purposes only. It is not intended to be comprehensive or constitute legal advice. You should seek formal legal or other professional advice in relation to your particular circumstances before relying on the content of this article.

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