Choosing the best legal structure for your business

The legal structure that you choose for your business affects the ownership, tax structure, risks and future of that business. Choosing the legal structure that best meets your needs may:

- Protect you from risks that you can avoid.
- Help you to minimise your taxation liability.
- Save you time and minimise paperwork.
- Help you to avoid government regulation and unnecessary “red tape”.

On the other hand, if you choose the wrong legal structure, you may end up paying more tax than you need to, or be swamped with paperwork and government fees.

Types of business structure

A business can be legally structured in several ways. The legal structure in which a business operates depends on many variables including the number and relationship of the people involved in the business, the length of time the business is planning to run, expected income from the business or the activities of the business itself.

The three most common legal structures are a Sole Trader, a Partnership or a Proprietary Limited Company. You could also operate your business using a trust structure.

A **sole trader** is an individual who runs the business without partners or a company structure. This is the easiest and cheapest way of structuring a business. The sole trader has full control of the business including ownership of all profits and responsibility of all debts. A partnership involves two or more co-owners participating together in a business.

A **partnership** requires an intention to share profits and an understanding that partners act on behalf of each other in business. Therefore a decision made by one partner automatically makes the other partner responsible as well. Partners in a partnership are collectively responsible for all business debts and profits, and also have full control of the business. Sole traders and partnerships should consider insuring against unexpected debt.

A **Proprietary Limited Company** is a more complex form of business structure. It must be established under the Corporations Law which states that Company Directors have certain legal obligations which must be met. A business with a proprietary limited company structure is considered as a separate entity from the business person running it so it has different profit distribution, taxation and legal responsibilities than a sole trader or partnership.

How to make the best choice

There are advantages and disadvantages to each of these structures.

To make the best choice, it is recommended that you consider both the advantages and the disadvantages in view of your personal situation and the nature and objectives of your business venture. As this is a very complex task, seek the advice of your solicitor and your accountant.

Some issues that you should discuss with your advisors include:

1. Whether you start-up as a sole trader, a partnership or a company, the costs and risks are quite different. Find out which structure will best suit your business needs.
2. Which legal structure will help you to minimise your taxation liability in view of the annual net profit that you expect your business to make?
3. Owning a business takes a broad range of skills and personal abilities. Do you have enough knowledge, determination and experience to succeed by yourself? If not, will this affect how you structure your business?
4. If you need a partner to share the costs and risks of operating your business, have you considered how much money they should invest in the business and whether they have the right kind of experience that you need?
5. Starting a business with a partner requires you both to agree on the goals and the direction of the business. If you intend trading as a partnership, you need a partnership agreement that makes sure that each partner has a clear understanding of their rights and responsibilities.
6. All business names need to be registered with the Department of Tourism, Fair Trading and Wine Industry Development. Their staff at the Business Names Register will record your business name and help to prevent other people from using it. To find out how to register call (07) 3246 1581 or SmartLicence on 1800 061 631.
7. Businesses, depending on gross turnover, may need to register for a ABN Australian Business Number with the Australian Tax Office www.ato.gov.au
8. If you decide to register and operate as a Proprietary Limited company, you must understand your responsibilities and duties as a company director. For more information, speak to your solicitor or call the Australian Securities and Investments Commission for a copy of their publication “The Watchdog’s Guide” (telephone (07) 3867 4900 or visit www.asic.gov.au)

Advantages and Disadvantages

	Sole Trader	Partnership	Proprietary Limited Company
Advantages	• Easy to set up • Inexpensive • Independence • Few government regulations • All profits to sole trader • Easy to close • Total privacy • Non-disclosure of profits to public	• Relatively easy to start • Low cost • Additional capital from partner • More expertise from partner • Few government regulations • Possible tax advantages – income splitting • Shared risk • Non-disclosure of profits to public	• Limited liability • Separate legal entity • Organised control • Shares transferable • Possible tax advantages • Ability to control authority of shareholders through type of shares issued
Disadvantages	• Unlimited liability • Few tax concessions • Possible lack of capital • Possible limit of expertise • Lack of continuity – reliant on one person only – affected by sickness, holidays, retirement, death	• Unlimited liability • Each partner equally and jointly responsible • Possible executive management problems (who is the boss?) • Lack of continuity – reliant on partners only • Expensive to set up and maintain	• Government regulations (includes annual returns to ASIC) • Possible taxation disadvantages • Responsibilities of directors • Charter restrictions • Public Disclosure

Further information

The following fact sheets provide further information about these issues:

- Duties and responsibilities of company directors
- Set up as a company
- Set up as a partnership
- Set up as a sole trader
- Tax implications of a company
- Tax implications of a partnership
- Tax implications of a sole trader