Set up as a trust

If you are thinking of going into business for yourself, one of your most important decisions to be made will be choosing the correct legal structure for your business. In today's competitive business environment, your choice of business structure could affect your business' long term success. Each structure has important differences in relation to tax liability, personal financial liabilities and set up costs. The legal structure that you choose for your business will affect:

- Who legally owns your business.
- The legal responsibilities and rights of the owner/s.
- How effectively your structure will protect you from liabilities and legal actions.
- The types and amount of tax that the owners and the business are liable to pay.
- A number of other business issues such as how regulated your business activities will be.

For specific advice about choosing the best legal structure for your business, we recommend that you consult with your solicitor and your accountant before making a decision. For further general information about choosing the best legal structure, please refer to fact sheet *Choosing the best legal structure for your business* [insert link].

What is a trust?

A trust is a relationship where a trustee (an individual or a company) carries on business for the benefit of a range of people (known as the beneficiaries). It is commonplace for the trustee of a trust to be a company (referred to as a corporate trustee) because this is more tax effective.

A trust is not a separate legal entity. Rather a trust is a relationship under which the trustee holds property for the benefit of the beneficiaries. For instance, a trustee may carry on a business for the benefit of a particular family and distribute the yearly profit to them. A trust may be discretionary (ie be able to benefit a range of people in the proportions that the trustee decides) or have fixed interests (ie will benefit certain people in predetermined proportions). Trust income is usually distributed among a wide range of people, usually including the extended family of the business principal.

Advantages

- Ownership of the business by a corporate trustee provides asset protections and limits your liability in relation to your business.
- Trusts are very flexible for tax purposes. A discretionary trust provides flexibility in relation to the distribution of income and capital gain amongst beneficiaries. You and your business partners or family members could be the directors and shareholders of the trustee company and could dictate when and where income or capital is distributed.
- Beneficiaries of a trust are generally not liable for the debts of the trust, unlike sole traders or partners in a partnership.
- Beneficiaries of a trust pay tax on income they receive from a trust at their own marginal rates.
- Generally speaking, the eventual sale of any capital assets of a trust (such as your business premises) will attract Capital Gains Tax (CGT) on any positive difference between the cost of the capital asset and the proceeds received on disposal. However, trusts receive a 50% discount on the amount of CGT payable on capital assets which have been held for more than 12 months.

Disadvantages

- Although a trust can be an exceedingly useful structure for a small business, with excellent flexibility and access to small business tax concessions, it is a very poor vehicle by which to grow a business beyond a certain point because a trust does not easily accommodate a business that is managed by numerous people.
- A trust is not a separate legal entity - similar to a partnership, a trust is a flow through vehicle (of trust income) for tax purposes - this means that the corporate trustee will pay the company tax rate of 30% on trust income and once the income is distributed to you and the other beneficiaries, you will be liable to pay "top-up tax" up to your personal marginal tax rate.
- The trust itself has no liability as such. A trustee is completely personally liable for the debts of the trust, but has an indemnity out of trust assets. However, should trust assets prove to be insufficient, the trustee will be personally liable for the balance of the debts of the business. Accordingly, having an individual as trustee is not recommended whereas, if the trustee is a company, the trustee's liability will be limited to the assets of the company, and not extend to any party's personal assets.
- Tax losses remain "trapped" in the trust to be offset against future trust income. Any tax losses of the trust cannot be used to offset income that beneficiaries have earned from other sources.
- Any income not distributed to beneficiaries of the trust is taxed at the highest marginal tax rate (as at 30 June 2006 - 48.5%).

How do I form a trust?

You will need to speak to your legal advisor in relation to have a trust deed drafted. This deed is the document by which the trust will operate.

Further information

Your solicitor and accountant will help you decide whether a trust is the best structure for your business and your personal circumstances. They can also give you specialist advice and assistance relating to operating a business through a trust.

The following fact sheets provide further information on these issues:

- Legal aspects of succession planning
- Tax implications of a trust