Selecting the legal structure of your business

INTRODUCTION

What form of legal entity should I use?

How should I organise my business?

The entities most commonly used by small businesses are:

(1) Sole trader,
(2) Partnership,
(3) Corporations, and
(4) Trusts.

Comparison of Legal Entities

	Sole Trader	**Partnership**	**Company**	**Trust**
Difficulty and Cost to Create	Low	Medium	High	High
Difficulty and Cost to Maintain	Low	Low	High	High
Difficulty and Cost to Shut Down	Low	Medium	Medium	Medium
Tax Flexibility	Low	Medium	Medium	High
Flexibility of Risk Management	Low	Low	High	High
Flexibility of Ownership	Low	Low	High	High

SOLE TRADER

A majority of small businesses operate as sole traders. This type of business organisation is the simplest and is the form usually chosen by the one-person business, in which the owner and the person in control are the same person.

In a business run as a sole trader, besides the employees, the trader is the enterprise and the enterprise is the trader. There is no one else involved. Its primary advantage is its ease of formation.

The most important disadvantages are:

- it can have only one owner; and
- the owner is individually responsible for all losses of the business.

GETTING STARTED

Selecting a Name and Beginning

You can start a sole trader simply by beginning to conduct your business.

You should open a separate bank account to keep track of your business's finances and keep records of all of the expenses and revenues connected with running the business.

A sole trader often operates under the name of the individual owner, but can use other names. If the name selected is not yours, you must obtain a state government licence to do so called a "registered business name". In selecting a name make sure it is not the same or similar to the name of another business. Also, note you cannot use the words "incorporated, Inc, Corporation, Company or Co." unless your business is a corporation.

Obtaining Permits and Licenses

You will need business licenses or permits regardless of the type of entity. Examples of the licenses often required are business licenses, zoning occupancy permits and tax registrations. You should call the state government Business Licence Information Centre and your local Council for information and application forms.

CONTROL

Who Owns the Business?

A sole trader owns all the assets of the business directly. A business run by a sole trader is by definition owned by only one individual—ownership by more than one person creates a partnership.

Who Controls the Business?

Generally, the owner of the sole trader controls the business. A sole trader may hire employees to help manage the business, but will have legal responsibility for the decisions made by employees and has ultimate control over the business.

Liability

For a sole trader, the business and the owner are one and the same. There is no separate legal entity. There is no separate legal "person." A sole proprietor has unlimited personal responsibility for the business's liabilities.

For example, if your business cannot pay for its supplies, the suppliers can sue you individually. The business creditors can take action against both the business's assets and your personal assets, including your bank account, car or house. You may be able to protect your personal assets from business risks by transferring them to your spouse or children. There may be tax and other reasons why this is not a good idea; seek the advice of a lawyer first. The reverse is also true; ie, your personal creditors can make claims against your business's assets.

Insurance can cover many of the risks of running a sole trader. Some businesses are not very risky, so the personal liability may not be a great concern. However, you should understand that if you choose to operate your business as a sole trader and lose money (which insurance will not cover), you will be personally liable for the loss.

CONTINUITY AND TRANSFERABILITY

How Long Does a Sole trader Last?

A sole trader can exist as long as its owner is alive and desires to continue the business. When the owner dies, the assets and liabilities of the business become part of the owner's estate. Those in control of the estate decide the fate of the business.

Can You Sell Your Business?

A sole proprietor can freely transfer a business by selling all or a portion of the assets of the business.

Taxes

A sole proprietor pays tax on all income from the business at applicable individual tax rates. The business income and allowable business expenses are reflected on the individual tax return. The business does not have a separate income tax return from the sole trader.

Pros and Cons

Pros

- Is inexpensive to start.
- Is simple to run.
- No separate tax return required.

Cons

- Owner has unlimited personal liability for business liabilities.
- Business has unlimited liability for owner's personal liabilities.
- Ownership is limited to one person.

PARTNERSHIPS

A partnership is the relationship created when two or more individuals agree to carry on a business in common with a view to profit. Unlike a company there is no new legal entity. Like a sole trader, the business is not separate from the people conducting it. The partnership is the relationship between those people through which they jointly act, own the assets, and make profits and losses.

The primary advantage of partnerships is that they can have more than one owner; the most important disadvantage is that the general partners are personally responsible for the losses and other obligations of the business.

There are two types of partnerships: general partnerships and limited partnerships. All partners under a general partnership are responsible for the actions and liabilities of the partnership business. A limited partnership consists of one or more general partners (ie, those who are generally liable for the business) and one or more limited partners (ie, those who have limited liability).

Start by Agreeing

You can start a partnership by agreeing with one or more individuals to jointly own and share the profits of a business. There is no limit on the type of partners (ie, individuals, other partnerships or corporations) you may have in your business. With some exceptions, there can be no more than 50 partners.

A general partnership is deceptively easy to start because it can be formed by an oral agreement. It is dangerous to be in partnership without a written agreement signed by all partners.

The agreement should address the major issues relating to the business, including:

- How much time and/or money the partners will contribute to the business;
- How business decisions will be made;
- How profits and losses will be shared;
- What will happen to the business and to a partner's share of the business if that partner dies, becomes disabled or stops working or contributing to the business;
- How long the partnership will exist; and
- When the partnership will make distributions to its partners (ie, payments of income earned based upon partnership share).

A limited partnership may be created only by following certain steps set out by statute. If the statutory requirements are not followed, a limited partnership will be treated as a general partnership; therefore, it is important that you consult with a lawyer if creating a limited partnership. Limited partnerships are rare.

Selecting a Name

As with the sole trader, partnerships often use the name of the partners as the name of the business.

If the partners' names are not used, you must obtain a state government licence to use any other name: a "registered business name". In selecting a name make sure it is not the same or similar to the name of another business. Also, note you cannot use the words "incorporated, Inc., Corporation, Company or Co." unless your business is a corporation.

Keeping Account

The partnership should keep separate bank accounts and financial records for the business so the partners know whether there are profits and losses, and how much of either they receive.

CONTROL

Who Owns the Business?

The partnership agreement should state what percentage of the business and profits each partner will own. In the absence of an agreement, each partner will own an equal portion of the business and profits (as well as the liabilities) of the business.

Who Controls the Business?

The partnership agreement should specify who will control and manage the business of the partnership. In the absence of an agreement, all general partners have equal control and equal management rights over the business. This means that all of the partners must consent and agree to partnership decisions. It is important to note however, that any partner can bind the partnership and the individual partners to contracts or legal obligations, even without the approval of the other partners.

In a limited partnership, the general partners handle the management and control of the business. State law restricts the types of control and management the limited partners can undertake without jeopardising the limited partnership's status.

LIABILITY

General Partners

The general partners are "jointly and severally" liable for the partnership; ie, all of the partners are liable together and each general partner is individually liable for all of the obligations of the partnership. This means that a creditor of the partnership could require you individually to pay all the money the creditor is owed. Your partners would then reimburse you for their share of the debt or loss.

Before you decide to join a general partnership, determine whether your partners can financially afford to share the losses of the partnership. If you are the only partner with any assets or money, the creditors of the partnership can require you to pay them, and you will be unable to get reimbursement from your partners.

Limited Partners

Limited partners do not have personal liability for the business of the partnership. Limited partners are at risk only to the extent of their previously agreed contributions to the partnership.

CONTINUITY AND TRANSFERABILITY

How Long Does a Partnership Last?

A partnership exists as long as the partners agree it will and as long as all of the general partners remain in the partnership. Unless otherwise agreed, if a general partner dies or leaves the partnership, the partnership dissolves. The assets of the partnership must be sold or distributed to pay first the creditors of the partnership and then the partners. The partnership agreement should provide for the continuation of the business by the remaining partners, in which case it may not have to be sold upon the withdrawal of a general partner. When a general partner leaves a partnership, he or she is entitled to an accounting that will determine his or her share of the assets and profits of the partnership. The agreement should also cover how a partner will be paid for his or her share of the partnership when he or she leaves or dies.

Can a Partner Sell His or Her Share of the Partnership?

The partnership agreement should state whether a partner can sell his or her partnership share. Even if a partner does transfer a share of the partnership, he or she will remain personally liable for the business losses incurred prior to the sale of that interest.

Taxes

The partnership itself is not responsible for paying taxes on the income generated by the business. A partnership tax return is filed, but for informational purposes only. Instead, each partner individually pays taxes on his or her share of the business income. The profits and losses “flow down” from the partnership to the individual partners. In certain cases, a partner may be required to pay tax on income from the partnership, even without having received any of the income.

Pros and Cons

Pros

- Is a very flexible form of business.
- Permits ownership by more than one individual.
- Allows some income splitting
- Has few legal formalities for its maintenance.
- Cheap and simple to establish and run.

Cons

- Partnership decision-making and disagreements can be difficult.
- Partners have unlimited personal liability for business losses.
- Partnership is legally responsible for the business acts of each partner.
- Dealing with partnership interest is difficult without consent of all partners.

CORPORATIONS

The company is more complex than the sole trader or the partnership, but it has certain advantages that may make it worth considering as a business form.

Companies are sometimes called corporations.

A company is a separate legal entity. Because of this, the owners of the company (known as its shareholders) may not be personally responsible for the losses of the business. Although a company usually has more than one owner, it is possible for only one individual to create and own 100 per cent of a corporation.

The most important reason for you to consider incorporating your business is because a company is its own legal "person" separate from its owners.
This allows conduct of a venture through a structure that has a true life of its own. Many ventures are bigger than or something more than the people currently involved in them or at least something different. The separate status of a company reflects this and allows sophisticated planning to regulate the separate involvement of parties to a venture in ways impossible with a sole trader or a partnership. Complex profit sharing and power sharing systems can be established.

Separate legislation recognises incorporated associations, which are used for non-profit organisations, community associations, etc. There are no owners in an incorporated association, although there may be members. This booklet does not further discuss incorporated associations because businesses cannot use this form of company. Tierney Law has another booklet that deals in detail with incorporated associations.

GETTING STARTED

The Corporate Formalities

If you decide to do business as a corporate entity, you will have to comply with the legal requirements to create the company. Note that members of certain professions, such as doctors or lawyers, may need special rules.

The individuals who own the business (ie. the shareholders) must agree on the following to create a corporation:

- The name of the business.
- The total number of shares the company can sell or issue (known as "authorised shares").
- The number of shares each of the owners will buy.

- The amount of money or other property each owner will contribute to buy his or her shares.
- The business in which the company will engage.
- Who will manage the company (ie, who will be the directors and officers of the corporation).

Once the shareholders agree on these issues, they must prepare and file details of the proposed company with the Australian Securities Commission.

Fees

You cannot form a company without filing the application and paying an initial fee for filing the corporate documents. There is an annual fee for allowing the company to continue.

The company will also need a memorandum and articles of association, i.e. a set of rules of procedure by which the company is run. These include rules regarding shareholder meetings, director meetings, the number of officers in the company and the responsibilities of each officer.

Keeping Account

The company is a legal entity separate from its owners; therefore, it will need a separate bank account and separate records. The money and property that the shareholders pay to buy their shares, and the assets and money earned by the company, are owned by the company and not by the shareholders.

Company Name

When you send your corporate documents to the state, you must include the name of the corporation. If the name you have selected is already used by another company, your application will be rejected. You also should take care to avoid using a name that is similar to that of an existing company or product.

CONTROL

The Owners Have Ultimate Control

The shareholders of the company elect a group of individuals to act as the board of directors. Thus, those who hold a majority of the shares have ultimate control over the company. Terms of directors often are for more than one year. Shareholders can elect themselves to be on the board of directors.

Certain major decisions must be approved by the shareholders, such as amendments to the articles of incorporation, merger with another company and dissolving the corporation.

The Board of Directors Makes Major Decisions

The board of directors is responsible for the major decisions of the corporation. It must meet at least once a year. Each director on the board has one vote. Usually the vote of a majority of the directors is sufficient to approve a decision of the board. Directors may be paid for their services, although payment is not required. The board of directors elects the officers of the company. The officers usually consist of a president, vice-president, secretary and treasurer. One person may hold any or all of these offices.

Day-to-Day Decisions Are Made by the Officers

Officers of the company are responsible for running the day-to-day business of the corporation. Although they often are employees of the company and receive a salary, they can be non-employees and/or serve without pay. The shareholders can be elected as officers.

How Do the Owners Get Paid?

The company is a separate legal entity, and the money it makes belongs to the corporation. The board of directors decides whether from the companies funds it should reward shareholders by paying dividends to them. If dividends are not declared in any given period, a shareholder has no right to any of the money the company's business has made. Shareholders may also be an employee of the company and as such receive a salary or wages.

Liability

Primarily, the separate existence of a company means creditors of the company look to the company for payment. The individual shareholders are not as a matter of course personally liable for the losses of the business if the company is properly established and properly operated.

The shareholders' liability may be limited to their investment in the corporation. There are significant restrictions on this limited liability.

Shareholders can incur liability for the debts and action of the corporation.

Directors may be personally liable for the business's losses if, for example, they trade when the company is insolvent or do not observe the statutory requirements for running the company or do not keep the corporation's money, accounts and assets separate from their personal accounts.

Shareholders are legally responsible for the obligations of the corporation they guarantee: for example in order to borrow money or to rent premises. If the business fails, shareholders' loans to the company may be paid off only after the other loans of the company are paid. Directors and shareholders are responsible for crimes or civil wrongs they commit even if done in the company name.

Continuity and Transferability

The corporation, as a separate legal person, does not cease to exist if one or more of its owners die. Its corporate existence lasts as long as its shareholders so decide; a company's "life' is usually perpetual.

Ownership of a company can be transferred by sale of all or a portion of the shares. Additional owners can be added either by selling shares directly from the company or by having the current owners sell some of their shares.

Shareholders can agree to restrictions on the sale of shares, so they can control who owns the corporation.

Taxes

The company must file its own income tax returns and pay taxes on its profits. The company must report all income it has received from its business and may deduct certain expenses it has paid in conducting its business. The taxes paid by the company are taken in to account when assessing the tax on dividends distributed by the company.

Pros and Cons

Pros

- Provides some limited liability to owners.
- Is easy to transfer ownership in whole or in part.
- Is easy to add additional owners or investors.
- Allows complex and sophisticated arrangements.

Cons

- Is more costly to set up and maintain.
- Requires separate tax returns.
- Closely regulated by government.

TRUSTS

What is a Trust?

A trust is the obligation of a person who is the legal owner of property to hold the property for the benefit of another.

A trust creates new relationships of ownership. There is no new legal entity, in the sense that a new company or a new baby is created as a new person at law. A trust involves existing people, existing property, but put in a new relationship. They have a different status of ownership. Flexibility and power can come from this different status.

The person who sets up a trust is called "the settlor".

The person bound to hold the property and deal with it according to rules is called “the trustee”.

The trust document will specify the rules. The law itself will set up rules.
The final element is a person benefited by the property: “the beneficiary”.

What is a Unit Trust?

Through a unit trust one person can control assets and conduct activity on behalf of a number of persons. The activity is performed by one person but others take the benefit. This sometimes allows easy dealings with part interest in assets. The document that sets up the trust can set up rules to control the holders of the beneficial interests that are often called when divided: units. This allows sophisticated flexible structures.

What is a Discretionary Trust?

Most trusts benefit a definite person; these are called fixed trusts. For example, Dad tells the son to look after the shack for the grandsons. Once the gift is made there are two owners: the son who appears to be the owner and the grandsons who have the real enjoyment of the property and who are in that sense the real or beneficial owners. Granddad might say the son is to hold the shack for only those of the grandsons who the son thinks will enjoy the property. Granddad may leave it up to the son to decide which of the grandsons get the shack. The son may be given discretion to decide. In this case the apparent owner is the same: the trustee. The real owner, the beneficial owner, would depend upon the words, “who you think will enjoy the shack”. The trustee has a discretion as to who will benefit and who will be the real owner. The person benefited may change, or may be decided later according to the discretion of the trustee. This is a discretionary trust or a flexible trust.

The common form of discretionary trust benefits not just the grandsons, but the whole family: “a family trust” or “family discretionary trust”. Rather than a specified person, there is a very broad and general description of possible beneficiaries and a broad discretion on how to benefit them

Continuity and Transferability

Trusts are limited by law to basically a single life time.

Unit trusts can allow sophisticated regulation of transfers of ownership. These would usually be matters of right.

A discretionary trust can flexibly change ownership or the benefits of ownership from time to time and year to year, depending on the exercise of discretion by the trustee.

Taxes

The trust must file its own income tax returns and pay taxes on its profits unless they are distributed to beneficiaries in the year they are earned.

A family discretionary trust helps tax planning. The flexibility of a discretionary trust makes easy splitting income or streaming different classes of income.

Flexibility of a Discretionary Trust

If property is held as a discretionary trust, the trustee can respond to a changing environment. It is easy to deal with people who marry or who are born into the family or beneficiaries who have a special need such as financial hardship, illness or disability.

By having the assets held in trust they are not available against the wishes of the trustee to satisfy a beneficiary's creditor, nor directly available in a matrimonial property settlement.

Thorough a discretionary trust the use of assets can be varied between different members of the family without having to transfer part interests between them. This could have capital gains tax and stamp duty advantages.

As the beneficiaries do not have any certain entitlement to the assets of the discretionary trust, when assessment is made for social security purposes the asset is not generally included even though it may be currently made available for the benefit of the pensioner. The income from a discretionary trust will only affect the income test of a beneficiary if a trustee exercises the discretion to apply the income for his or her benefit.

Getting Started

A family trust is established by completing a trust deed that sets out the terms of the trust and the responsibilities of the trustee. The trustee agrees to the terms and conditions of the trust deed, and assumes responsibility for maintaining and operating the trust appropriately. Often the trustee is a company controlled by the leading people behind the family or the venture. The trust deed also establishes who are to be the beneficiaries of the trust.

In the case of a discretionary trust, the range of beneficiaries can be quite broad provided they are defined in the trust deed with some certainty.

Generally, the primary beneficiaries comprise the family for whom the trust is established and the general beneficiaries comprise the extended family, relatives and related companies and trusts, charitable institutions or educational bodies, and a range of other beneficiaries. In the case of a unit trust, the deed will specify how the unit holders benefit.

Control

The trust deed and the law of trust set up the rules to control the venture. The trustee has control of the venture according to those rules. Sometimes a separate person has the power to sack the trustee and appoint another trustee.

Liability

The trustee is liable for the actions of the trust. It is common to use a company as trustee to limit liability. Usually the people who benefit from the trust are not responsible for it.

Pros and Cons

Pros
- Provides some limited liability to owners.
- Is easy to transfer benefits ownership in whole or in part with or without control.
- Is easy to add additional owners or investors.
- Allows complex and sophisticated arrangements.
- Flexible from year to year.

Cons
- Is costly to set up and maintain.
- Is complex
- Requires separate tax returns.

What is the best way to hold assets?

You can control the fate of your wealth by carefully structuring how it is held.

It is a good idea, if you can, to quarantine your business and non-business assets so that if there is a business failure your core wealth is not put in prejudice.

Having one member of the family, or some other structure, which is separated and quarantined from the business, is a useful tool in this.

All of this is risk management. You need to assess the likelihood of a business failure. If your likelihood of a business failure is very low, the value of such asset protection is to you, similarly low.

These strategies need to be implemented on a long-term basis. There needs to be a complete plan. It is not enough for instance to change the ownership of one asset, only to find that shortly thereafter you are using that asset to secure business loans.

In particular, if you transfer a half interest in the house of one of you to the other you will pay stamp duty of roughly 3% of the value of the interest transferred. This is effectively 3% of half the Government valuation as shown on your rates demand. There will be other bank fees. You would need to not only separate the asset, but also the debt secured against the asset. There is no point having the property solely in your spouse's name if there is bank lending over the property which secures business debt.

Once you separate one of you from the business liabilities you can then consider placing the assets in the name of that person. Ideally, as new assets are acquired, they can be placed appropriately, and then there is no transaction cost of transferring them back and forth.

One alternative is, instead of transferring existing assets you can have a loan to the person involved in the business to burden the asset that you are trying to protect in favour of the person who is quarantined outside the business liabilities.

These matters are best dealt with in conjunction with your accountant as well as your legal advisers.

How does tax impact on business structures?

Knowing the relationship between taxation liability and business structures can be fundamental to minimising taxation rates.

The taxation opportunities and pitfalls associated with small business structuring have become sharper with the relatively recent introduction of:

1. the 30% company tax rate;
2. the 50% discount on capital gains; and
3. the Small Business CGT concessions.

The 3O% Company Tax Rate

Once an individual taxpayer derives over $50,000, their marginal tax rate (plus Medicare) exceeds the corporate tax rate of 30%. Thus, for couples in small business, the attractiveness of private company tax rates becomes an issue broadly when combined taxable income exceeds $100,000.

Other than having investment capital locked away and accessing the complying superannuation fund tax rate of 15%, a corporate tax rate of 30% on earnings compares favorably to higher individual marginal tax rates.

However, accessing the corporate tax rate will often at best allow a tax deferral only. If individual shareholders are on marginal tax rates of say, 48.5%, any saving in having earnings taxed at 30% is lost on payment of a dividend to shareholders. Top-up' tax is effectively paid at that point representing the difference the company tax rate and the individual rate.

Private Company Loan Rules

The private company tax deferral is best accessed when shareholders are able to leave cash earned from business activities in the company. Company earnings accessed by individual or other non-corporate shareholders, may be accessed1 as a loan or alternatively as taxable payment such as dividends or salary.

The tax rules relevant to private company loans to shareholders (or their associates) typically require the loan to the company to be repaid within seven years at interest. Not to do so can result in up to tr4ple tax -the company is taxed on earnings, the unpaid loan balance is treated as an unfranked dividend to the shareholder (or associate), and the company's franking account is reduced.

Complying with the tax private company loans rules and in particular to effect minimum yearly loan repayments, will often require taxable dividend or salary payments to shareholders, thus bringing to an end (in part or in whole) the tax deferral achieved from accessing the corporate rate.
The management of private company loans to shareholders (and associates) is often the single largest ongoing tax compliance issue for small businesses using companies. How well such loans have been managed may soon become apparent to many small businesses, as this is an area which the Taxation Office is targeting.

No 5O% CGT Discount for Companies

Whilst commercial issues shoufd be the primary motivation in choosing a business structure, the primary tax attraction of using a company is access to the 30% corporate tax rate on earnings.

However, a key income tax reason why a company might not be chosen is that it is the one structure that does not offer access to the 50% CGT discount, whereas holding capital appreciating assets in a trust structure for more than 12 months does.

Trusts distributing income to Companies

Businesses conducted through a trust structure have, to date, usually been able to access both the 50% CGT discount in respect of asset sales, and the corporate tax rate of 30% by distributing income to a corporate beneficiary.
Again, unless cash transfers to the company as a trust beneficiary receiving an income distribution, the management of the private company loan rules again often becomes a tax compliance issue.

At the time this article was written the Government had announced that new rules impacting trust income distributions to companies (which access the 30% tax rate) are to be released.

Whilst the new law is to be operative from 12 December 2002, no details have yet been released. However, it is anticipated that the thrust of the new measures will either require cash to follow income distributions to companies more quickly than is presently the case or effectively result in the earlier payment of 'top-up' tax.

The Small Business CGT Concessions

How a small business is structured may also impact access to small business CGT concessions. As a rule of thumb the more simple the structure, the more likely is access to the small business concessions. For businesses with net assets of less than $5 million, achieving access to the Small Business CGT concessions can save a significant amount of capital gains tax on exit or restructuring.

To access any of the small business CGT concessions a number of 'basic' conditions have to be met. These are broadly:

1. The net value of assets owned by the business and related entities cannot exceed $5 million. Certain assets such the family home are excluded from this test.

2. Assets sold must be 'active assets'. This essentially means assets-used in carrying on a business or connected with a business, such as goodwill.

3. Company shares and units in a trust can also be 'active assets', if at least 80% of the market value of all assets held by the company or trust are in turn 'active assets'. However, for the disposal of shares and units there are additional tests which essentially require an individual to have at least 50% ownership and control of the company or trust.

If the above 'basic' conditions can be met there are four concessions that may, subject to a number of further conditions, apply. These are:

1. The 15-year exemption - allows a full exemption from CGT. This exemption may be available where business assets have been held for at least 15 years, and where the business principal is either at least 55 and retires, or is permanently incapacitated.

2. The Small Business 50% reduction - provides for a 50% CGT discount if the 'basic' conditions noted above must be met.

3. The Retirement Concession -essentially allows up to $500,000 of the taxable capital gain made on the sale of a business to be treated as a tax exempt eligible termination payment.

4. Small Business Rollover - broadly provides for a deferral of tax if part of the capital gain that is otherwise taxable is reinvested in business assets or equity in a small business.

The following example seeks to outline how these concessions might be applied in practice.

Example: Len, aged 40 is a pharmacist whose professional body requires him to conduct business as an individual. Thus, whilst pharmacy income is taxed at up to 48.5% as access to the corporate tax rate is not available, Len qualifies as an individual for the general 50% CGT discount on the sale of his business.
Len sells his business, which he established and ran for 10 years, for $1.6 million.

As a sole proprietor whose net worth (associates included) is less than $5 million selling an active asset (essentially business goodwill at a profit of $1.6 million), Len qualifies for not only the general 50% CGT discount but also the CGT Small Business Concessions.

Although Len does not qualify for the 15-year concession, he accesses a 50% CGT discount twice leaving only $400,000 of his $1.6 million profit on the sale of his business subject to tax.

At that point Len's options are to:

a. Retain $1.406 million now by paying tax of $194,000 ($400,000 at 48.5%) -an effective tax rate of 12.125% on $1.6 million;

b. Retain $1.2 million now and pay no tax now by deferring access to $400,000. This is achieved by rolling that amount into a superannuation fund as a tax exempt eligible termination payment. Should Len otherwise have very little stored away in superannuation, the $400,000 rolled over into a superannuation fund could come back to him tax-free on retirement. Earnings on the $400,000 placed in a complying superannuation fund would attract a 15% tax rate; or

c. Retain $1.2 million now and defer tax on the other $400.000, by using that amount to acquire new 'active assets'.

SUMMARY

The decision of what entity to select for your business needs care.
This booklet provides basic information regarding each type of entity. There may be additional factors for you to consider that are more complicated than those discussed in this booklet.

Start with a consideration of your needs and those of your venture. There is no single best structure for everyone. You need to find the structure that fits you best.

Structuring a small business tax effectively will often require consideration of a greater range of tax issues, than a larger business. Not only does the disparity between the taxation of income and capital gains need to be taken into account but also the more generous exit concessions for businesses that do not grow beyond a certain size. Getting it right on establishment or in restructuring is critical as choices made then impact the taxation of earnings, repatriation of profits to owners, and tax payable on exit.

You may need more than one entity. Will Freehold/ Long term Ownership nd leasehold/ Operations be the same entity? If all else is equal, keep it simple . Run with one entity unless there is a compelling need for the extra complexity.

You can resolve/amend the entities any time before settlement without a stamp duty penalty.

Consult us and your accountants before deciding which structure is best for your business.

Accountants usually have regular providers for trust and company creation. It is usually neater to run with your accountants' regular trust/company provider unless you want to custom build something.

These are important issues to be addressed before staring a new venture. As your business grows and changes, you should from time to time ask yourself whether the entity you have chosen remains the best form of organisation for your business.

More detailed booklets are available from Tierney Law on Partnerships, Trusts and Companies, Wills and Estate Planning.

In Whose Name Should You Purchase Investments?

There's no simple answer, but the right decision could save you thousands of dollars in tax. Let's take a look at seven options you have when preparing to invest...

Your options...	Advantages	Disadvantages
Purchasing investments in the name of the spouse on the lowest personal marginal tax rate	* Investment income is taxed at the lower income earner's personal marginal tax rate, helping to minimise the overall tax bill.	This partner has **total control** over the couple's investments. This means legally, they could make important investment decisions without consulting their spouse first.
Purchasing investments in the name of the spouse on the highest marginal tax rate	* When borrowing to invest, otherwise known as gearing, the borrowing costs are tax-deductible. Assuming the investor is on the highest marginal tax rate, they're also eligible for the highest possible tax deduction.	* Investment income and capital gains are taxed at a higher marginal tax rate. * Total legal responsibility, including decision making, is left with this spouse.
Purchasing investments in the name of a Trust	* Helps to protect assets from creditors in the event of bankruptcy. * Income can be distributed to beneficiaries of the Trust on a lower marginal tax rate - this offers significant tax benefits.	* Trusts **cannot** distribute losses to beneficiaries, making it difficult for investors to maximise the benefits of negative gearing. * Any income that's not distributed to beneficiaries is taxed at the top personal marginal tax rate of 47%.
Purchasing investments in the name of a Self-Managed Super	* Investment income and capital gains are both taxed at a maximum of 15%. However, if an asset is held for more than 12 months, capital gains are taxed at a maximum of just 10%. * If drawing a pension from the fund, income and capital gains are **tax-free within the fund.**	* A Self-Managed Super Fund is not permitted to borrow money for investment purchases. **Note:** Property and share investors may find this option particularly restricting. * Assets within the fund cannot be accessed until a condition of release is met, such as retirement (i.e. not before the age of 55 at the earliest).

Your options...	Advantages	Disadvantages
Purchasing investments in the name of a company	All investment income is taxed at 30% - significantly less than the highest marginal tax rate of 48.5% (including the Medicare Levy).	Profits cannot be distributed to specific shareholders. •? Companies cannot distribute losses to shareholders. Any losses must stay within the company and can only be offset against company income. * Companies are not eligible for the 50% capital gains tax discount, which is typically available to individuals when assets are held for longer than 12 months.
Purchasing investments in "joint names" as "joint tenants"	* Both parties have control over the investment and income/losses are shared equally. # Reverts to surviving owner on death, thereby avoiding any potential dispute of the Will.	* No opportunity to direct income/gains to a particular partner to maximise tax benefits; it is shared equally. More difficult to split after divorce.
Purchasing investments as "tenants in common"	Both parties have control over the investment and income/gains are distributed according to the proportion held. .	If one owner dies, their interest in the investment can be bequeathed to their chosen beneficiary. * No opportunity to direct income/gains to a particular partner to maximise tax benefits; it is distributed according to the proportion held.

10 questions to help you decide whose name to purchase investments in...

1. How much legal control do I want over my investments?
2. Will I need to access this capital at short notice?
3. How much tax will I incur on investment income?
4. How much tax will I pay if I make a capital gain'
5. How can I maximise any tax-deductible expenses?
6. How can I maximise the use of any tax losses incurred?
7. Is there an opportunity to split income and losses with family members?
8. What would happen to these investments if my spouse and I were to divorce?
9. What are the estate planning considerations?
10. Is there a need to protect this capital from potential creditors?

This booklet is not a complete statement of the law. It does not deal comprehensively with your particular situation.
This booklet is to provide general information to supplement our specific advice to you.
Do not act in reliance on this booklet without our specific advice.
We are responsible only if you give us specific instructions and for the specific advice we give.
This booklet was originally prepared in 1995 and has been updated as at the 30th August 2012.
It does not reflect changes to the law after that date.
You need to take specific advice on the possibility or effect of any such changes.