

Setting up a company or trust to operate a small business

If you are starting a small business, it is important that you choose the right business structure to maximise your chance of success. Often, individuals choose to enter a sole trader or partnership structure, forgetting that a business can also operate as company or a trust.

What is a company?

In Australia, the governing legislation regarding the formation of a company is the Corporations Act 2001 (Cth). In comparison to a sole trader or a partnership, a company is a separate legal entity. This means that it has the same rights as a natural person and can therefore incur debts and legal responsibilities. With a company, your shareholders or members own your business, and your directors are responsible for overseeing the operation of the company. It is possible to be both a director and a shareholder.

Generally, a small business owner will operate the company as a proprietary limited company (‘Pty

Ltd'). Unlike a public company, a proprietary limited company will not sell shares to the public to raise capital for the business.

What are the advantages of operating a business as a company?

There are two main advantages of operating a business using a company structure.
1. Limited liability
2. Lower tax rate

Limited liability means that generally, the owners of the company are not personally liable for any debts incurred by the company. Additionally, income generated by a company attracts a company tax rate of 25%. This is significantly lower than the highest tax rate you would receive for an individual.

What are the disadvantages of operating a business as a company?

There are two major disadvantages of operating a business as a company.
1. Complexity
2. Costs

A company is subject to various legal obligations under the Corporations Act 2001. These obligations are quite complex and create multiple duties which the directors must adhere to. Additionally, there are strict obligations regarding tax and superannuation which are enforced by the ATO. This includes lodging annual company tax returns with the ATO.

Lastly, a company must comply with ASIC's information requirements such as notifying ASIC about key changes within the company and keeping financial records.

Another disadvantage is the formation and ongoing costs. Formation costs refers to the costs of incorporating a business as a company, including registering the business name, professional advice fees and legal fees.

Ongoing costs refer to the administrative costs required to comply with legal requirements for a company. Further, there are additional costs associated with the winding up of the company.

What is a trust?

A trust is formed when a party (the trustee) carries on business for the benefit of another party (the beneficiary). This is set up through a formal trust deed which outlines how the trust will operate.

A trustee can be a person or a company and is responsible for everything in the trust including income and losses.

The trustee is obligated to control the property as its legal owner. However, in doing so the trustee must use the property to the benefit of the beneficiary.
What are the advantages of operating a small business through a trust?

The general advantage of a trust is that liability is limited to operating a business if a corporate trustee is appointed. For the beneficiaries, the debts of a trust do not create a liability for them.

What are the disadvantages of operating a small business through a trust?

A trustee can be held personally liable for the debts (subject to the trust deed).
Another disadvantage to operating a small business through a trust is that it is a complex process and is costly to establish and maintain.

For a small business, there are two categories of trusts under which you may want to conduct a business:
1. Discretionary
2. Unit

What is a discretionary trust?

A discretionary trust gives the trustee the discretion to determine the amount of assets distributed to the beneficiary. Generally, this type of trust is best suited to a family business or family assets in which the parents act as the trustees and the children as beneficiaries.

What is a unit trust?

A unit trust requires the trustee to distribute the income to the beneficiaries based on the units (percentage of the business) held by them. Generally, this type of trust is held by unrelated parties who have an interest in the business. The benefit of creating this type of trust is that it allows parties to raise investments from other investors by adding additional units to the trust.

How can Andersons help?

The structure of a business can have legal and financial consequences for a business. Establishing your small business as a company or a trust is complex to set up. It’s important that experienced financial, accounting and legal advice is sought to ensure that all processes are complied with.

If you have any questions on starting a company or trust for a small business, please contact Andersons Solicitors experienced **commercial team or contact our offices here.**

This article has been researched and written by Law Clerk Emily Stephens and settled by Felix Hoelscher.