

CHOOSING A BUSINESS STRUCTURE – ENTITY MATRIX

This matrix outlines the differences between the different entities.

| | Sole Trader | General Law Partnership (Business) | Tax Law Partnership (Joint Assets) | Company | Unit Trust | Discretionary Trust |
|------------------------------------|---------------------|---|---|--|---|--|
| Established by | N/A | Partnership agreement | Asset title | Constitution | Trust deed | Trust deed |
| Establishment and operating costs | Low | Medium | As per asset | High | High | High |
| Perpetual existence | Terminates on death | Terminates on change of partners | Terminates on disposal of asset | Yes, until wound up by members or creditors | Must vest within certain period | Must vest within certain period |
| Limited liability | No | No | No | Yes | Yes, if corporate trustee | Yes, if corporate trustee |
| Controlled by | Individuals | Partners | Partners | Directors – day to day management Shareholders – ultimate decision making | Trustee – day to day management Appointor (often unit holders) – power to appoint/dismiss Trustee | Trustee – day to day management Appointor – power to appoint/dismiss Trustee |
| Flexibility for new equity holders | No | Yes, special tax rules apply to admission or retirement of partners | Yes, but requires legal transfer of title | Yes Care needed if incorporated pre-CGT | Yes | Yes Care needed re definition of ‘family group’ especially if family trust election |
| Does principal have fixed interest | Yes | Yes | Yes | Yes | Yes in broad terms Tax definition of ‘fixed trust’ requires units to be issued or redeemed at market value | No |

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|---|---|--|---|--|---|--|
| Method of distribution to equity holders | Wholly to sole trader | Distribution in proportion to partnership share Partners salary if allowed in partnership agreement | Distribution in proportion to ownership of asset | Dividends according to shareholding Flexibility via different share classes, can emulate discretionary trust | Trust distribution in accordance with unit holding Proportionate approach where tax and accounting profit differ | Trust distribution in accordance with trustee resolution Proportionate approach where tax and accounting profit differ |
| Ability of principal (or associate) to withdraw money | As drawings | As partner drawings | As partner drawings | May be unable to frank dividends until tax paid on profits and franking credits available Loans may be deemed dividends Division 7A | As paid or applied by trustee Trust deed and tax law have special provisions for unpaid present entitlements | As paid or applied by trustee Trust deed and tax law have special provisions for unpaid present entitlements |
| Asset protection | Legal structure provides no protection, can be managed with insurance | Legal structure provides no protection, can be managed with insurance | Legal structure provides no protection, can be managed with insurance | Yes, subject to personal liability of directors | Yes, if appointor is the unit holders | Yes, if joint appointors include an independent person, otherwise bankruptcy trustee may seek to exercise power of appointment |
| Issues for families | N/A | Not suitable for children under 18 | Family members are given independent property rights | Personal liability of directors Principal can give income & assets to family and retain control by issuing voting shares | Family members are given property rights via trust deed Principal can exercise limited control as trustee | Principal can give income & assets to family and retain control as trustee and appointor |
| Issues for unrelated parties | N/A | Joint and several liability | Partners retain independent property rights | No joint and several liability Established legal rights for shareholders | Unit holders retain independent property rights via trust deed | Generally not suitable due to power of trustee and appointor |

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| Tax rate | Individual marginal rates Average rate (including Medicare) is lower than company rate below \$142,000 (2010/11) | Partners' marginal rates | Partners' marginal rates | Company rate (30%) Allows deferral of tax on income in excess of \$80,000 (2010/11) by delaying dividends until low income years | Beneficiaries' marginal rates (or top marginal rate if retained in trust) | Beneficiaries' marginal rates (or top marginal rate if retained in trust) |
| Basis of accounting for tax purposes | According to type of business Former STS taxpayers can use cash | According to type of business Former STS taxpayers can use cash | According to type of asset, usually cash | Accruals Former STS taxpayers can use cash | Accruals Former STS taxpayers can use cash | Accruals Former STS taxpayers can use cash |
| Streaming of Income | No | No | No | Unequal dividends via different classes of shares, but not unequal franking percentage Can't stream different classes of income | Possibly unequal distributions via different classes of units. Streaming different classes of income unresolved (Bamford case) | Unequal distributions possible via trustee discretion Streaming different classes of income unresolved (Bamford case) |
| Distribution of losses | Individual can use | Partners can use | Partners can use | Remain in company, must meet tests to recoup (except PSI) | Remain in trust, must meet tests to recoup (except PSI) | Remain in trust, must meet tests to recoup (except PSI) |
| Transfer of losses | No | No | No | Yes, if part of consolidated group | No | No |
| PAYG instalment arrangements | Paid by individual | Paid by individuals | Paid by individuals | Paid by company | Only paid if income retained in trust | Only paid if income retained in trust |
| Employment of principal | No | No | No | Yes | Yes | Yes |
| Remuneration for associates | Yes, limited by s26-35 and PSI rules | Yes, limited by s26-35 and PSI rules | No | Yes, limited by s109 and PSI rules | Yes, limited by PSI and general anti-avoidance | Yes, limited by PSI and general anti-avoidance |

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|--|---|---|--|---|---|---|
| FBT applicable to benefits provided to principal | No | No | No | Yes | Yes | Yes |
| Superannuation contributions | Self employed | Self employed | N/A | Employer sponsored Possible maximum contributions for family employees (Ryan case) | Employer sponsored | Employer sponsored |
| 50% CGT discount | Yes | CGT applies to individual partners, not to partnership | Yes if asset held for more than 12 months | No Generally unsuitable for real estate or passive investments expected to increase in value | Yes, but the benefit is limited by CGT Event E4 | Yes |
| Small business CGT concessions | Yes | CGT applies to individual partners, not to partnership | CGT applies to individual partners, not to partnership | Yes Significant individual test and other conditions apply | Yes Significant individual test and other conditions apply | Yes Significant individual test and other conditions apply |
| Tax concessions available | All primary production Small business trading stock, prepayments & depreciation Entrepreneurs' tax offset | All primary production (some at partner level) Small business trading stock, prepayments & depreciation Entrepreneurs' tax offset | N/A | Some primary production (no averaging or farm management deposits) Small business trading stock, prepayments & depreciation Entrepreneurs' tax offset Some concessions "lost" because untaxed book profits become unfranked dividends. | Some primary production (no averaging or farm management deposits) Small business trading stock, prepayments & depreciation Entrepreneurs' tax offset | Some primary production (no averaging or farm management deposits) Small business trading stock, prepayments & depreciation Entrepreneurs' tax offset |

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| Non-commercial losses rules apply | Yes | Yes, to individual partners | No, generally not business income | No | No | No |
| Personal services income rules | Limited deductions | Limited deductions and attribution to individuals Personal services entity loss is deductible to the individual | N/A | Limited deductions and attribution to individuals Personal services entity loss is deductible to the individual | Limited deductions and attribution to individuals Personal services entity loss is deductible to the individual | Limited deductions and attribution to individuals Personal services entity loss is deductible to the individual |
| Specific anti-avoidance provisions | | Unearned income of minors Uncontrolled partnership income Sham partnership agreements | Unearned income of minors | Division 7A Debt & equity rules Value shifting rules | Unearned income of minors Trust loss rules | Unearned income of minors Trust loss rules |