Business structures and restructures: Is your structure working against you?

Many business owners don't realise that the business has outgrown its structure until something comes up – and this something is usually something negative.

Are your assets at risk?

Legal action by employees, customers and suppliers as well as divorce are the two primary risk issues for many business operators. If you have been operating as a sole trade or as a partner in a partnership or have simply been holding all business assets in a single entity, your structure may not provide sufficient asset protection. If any personal assets or valuable assets of the business are held in the same entity which carries on the trading operations of the business, those assets may be at risk. To protect your assets it is generally preferable to separate as many valuable assets as possible from the trading operations.

Can you introduce new business partners or investors?

If you want to provide key employees or investors with an equity interest in your business, your current business structure may not allow for this. For example, it is not generally possible to provide fixed entitlements to the profits of a business operated by a discretionary trust.

Entities such as companies and unit trusts are a much more effective vehicle to facilitate the introduction of new equity partners as they can provide a fixed interest in the income and capital gains generated by the business. New investors can also potentially claim interest deductions on funds borrowed to invest in the company or unit trust.

Reinvesting in growth

Reinvesting profits in your business is important if you have or expect a strong growth path. Some business structures however don't readily facilitate profits being retained by the business. For example, it is generally more difficult for a trust to retain profits, as the trustee of a trust is taxed on these profits at penalty tax rates if they are not distributed to the beneficiaries of the trust each year. This is compared to private companies where profits are taxed at a maximum rate of 30% or 28.5% and can be retained in the company without the need to distribute these profits annually.

Can you take money out of the business?

When you first established your business, it's hard to know what your profits are going to be and for many, there are a few lean years of losses to get things up and running. Your personal circumstances might have changed as well – marriage, children, a spouse, etc. These changes can drive the need for change. The structure of your business has a direct impact on how money flows through it to the investors. For example,

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one of the benefits of a discretionary trust is that the income of the trust can be distributed to any of the beneficiaries of the trust in any proportion, and that proportion can change annually.

Impeding international expansion

If you are contemplating expanding overseas this can significantly increase the complexity of your operations. All of a sudden you will be exposed to a new set of Australian tax rules in addition to the legal and regulatory requirements that will need to be considered in the foreign jurisdiction. On top of the complexity, control may also become an issue. The right business structure can limit your exposure to risk.

Access to tax incentives and concessions

Research & Development (R&D) concessions are only available to companies. If you have a significant level of R&D activity that could potentially qualify for the tax incentives, it's worth exploring your options if you are not already in a company structure.

Can you exit your business?

The business lifecycle has shortened considerably with less business owners seeking to create empires but more opportunistic business models. The wrong structure will limit your ability to sell your business interests and may have a dramatic and detrimental impact on the amount of tax you pay on the sale proceeds. It's important that you explore this issue well before you actually plan to sell or reduce your stake in the business.