

Business structures- which one should I use?

Deciding the most appropriate structure for your business can be difficult. Each type of business entity has its own unique advantages and disadvantages. The following outlines some of these and can help when deciding which structure best suits your needs.

Sole trader

Advantages

- ✦ Simple and does not involve any costs relating to establishment or administration of a separate entity.
- ✦ The income is subject to progressive rates of individual tax.

Disadvantages

- ✦ Does not easily permit equalising of income with other family members.
- ✦ Does not provide limited liability.
- ✦ Income is subject to provisional tax.

Summary

- ✦ This form is most satisfactory for small businesses, where other family members have other income or where there are no family members to share income with.

Partnerships

Advantages

- ✦ Simple and not expensive to establish or administer.
- ✦ Can provide for income to be shared in desired (fixed) proportions.
- ✦ Tax is paid at personal rates.
- ✦ Losses are deductible against other income, subject to certain loss offset limits.

Disadvantages

- ✦ No limited liability.
- ✦ Income distributions may be inflexible.
- ✦ Income is subject to provisional tax.

Summary

- ✦ Best used for husband and wife businesses where simplicity and equalising of income achieves maximum effectiveness.

Company

Advantages

- ✦ It is generally well understood by financial institutions and customers.
- ✦ Provides limited liability, although most lending institutions will require personal guarantees.
- ✦ Permits splitting of dividend income to family members through shareholdings.
- ✦ Dividends may have imputation credits attached which will reduce or eliminate the individual's tax liability
- ✦ If the company is a 'qualifying company', dividends will either carry imputation credits or be tax-exempt, and tax losses can be attributed to shareholders (if the company is also a 'loss attributing qualifying company'.
- ✦ The Companies Act 1993 allows the registration of a 'one person' company.

Disadvantages

- ✦ Income is taxed at a flat rate of 33%.
- ✦ Costs of establishment and administration.
- ✦ Splitting of income by way of shareholding is inflexible and cumbersome.
- ✦ The company tax rate may be higher than that applicable to individuals with relatively low levels of income.
- ✦ Except in the case of a 'loss attributing qualifying company', losses can be utilised only in the company (or within a group of companies) and are available for carry forward only where there has been continuity of ownership.

Summary

- ✦ Where the company 'profit' is distributed by way of salary, the salary is deductible and taxed at the individual marginal rates. Alternatively, profits distributed by way of dividend may have imputation credits attached, eliminating the double taxing of company income. The 'qualifying company'

tax regime can also permit beneficial treatments of dividends and losses.

Disclaimer

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Trusts

Advantages

- ✦ Provides maximum flexibility and distribution of income or capital gains to family members.
- ✦ Income vested in beneficiaries (beneficiary income) during the year or within 6 months thereafter is taxed at personal tax rates.
- ✦ Income not vested in beneficiaries, ie trustee income, is taxed at a flat rate of 33%.

Disadvantages

- ✦ Not always understood by financial institutions and creates problems when borrowing.
- ✦ Is relatively expensive to administer where a corporate trustee is used.
- ✦ Losses can be recouped only against future trust income.
- ✦ Trustees are required to comply with New Zealand trust laws.
- ✦ For the 2001-02 and subsequent income years, distributions of beneficiary income from trusts to children under 16 years will generally be taxed at a flat rate of 33%.

Summary:

- ✦ The profits may be distributed as beneficiary income and are taxed at the beneficiaries' individual marginal tax rates.

Finally

- ✦ Talk to us before deciding on any business structure. There may be tax implications depending on your particular circumstances that may need to be considered.

See Us First

- ✦ Before making any financial decisions.
- ✦ To assist you in meeting the necessary legal or financial requirements.

- ✦ If you consider that any of the issues contained in this fact sheet may affect you.

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