LEGAL ASPECTS FOR SMALL BUSINESS
SMALL BUSINESS MANAGEMENT CERTIFICATE

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MEADOWBANK TAFE

Thank you for inviting me to address you on this topic today. The topic, Legal Aspects for Small Business is a very wide one. Today I will give you an overview of legal structures for small business and perhaps, touch on tax aspects of these as well.

SOLE TRADER

Small business generally grows through a number of business structure stages as the business grows and matures. Typically, most small businesses will start life with the Operator running the business as a "Sole Trader'. This means that the owner of the business operates on his/her own without any other legal structures in place and, for tax purposes, the business forms part of the tax return submitted by the individual.

As a sole trader, the owner is permitted to register a business name (Department of Fair Trading, 175 Castlereagh Street) and having registered this name the owner can advertise under this name and can open a bank account in the registered business name.

Reasons for registering a business name:- to enable one to use a 'catchy' name for advertising purposes or to perhaps indicate the locality one operates in (e.g. I used to operate as Leichhardt Taxation Services) which when advertising, assists in drawing clients from your locality.

The Tax Office also expects that small businesses, whether operating as sole traders or otherwise, to keep their business affairs separate from their private. This is why it is essential to set up a separate bank account for your business, either in the name of the registered business name, or simply as 'Joe Blogg – Business Account'.

Having set up this business bank account, all income from the business should be banked into the account and all expenses paid by cheque out of the account. The biggest single problem I have encounted with small business operators, is the mingling of private and business accounts.

When one operates one's own business, how do you get paid? Any payment from the business to you, is not a wage or salary as such, but an advance or 'drawing' against the expected profit for that year. So to keep things tidy for tax purposes, I advise small business clients to draw a cheque for notional wages (called 'drawings') and deposit the cheque into their private account to enable them to pay their own personal living expenses without messing up the business account.

This is not to say that the business cannot pay a portion of home expenses. If you operate your business from home; you can do this by either reimbursing your private account for the portion of expenses used by the business or by drawing two cheques for a payment – one from the business account and one from your private account (for such expenses as electricity/gas, telephone,. Contents insurance, rent etc.)

Legal Problems

A sole trader is exposed totally, for any debts that are incurred by the business, or if someone sues the business for negligence or failure to perform. (In this, it is essential that the sole trader cover himself for all eventualities, such as taking out Professional Indemnity Insurance (if you are a service provider), Public Liability Insurance (particularly if you operate a business such as a shop) and to keep business going if you are sick or injured, you should take out Sickness and Accident Insurance). Unfortunately, many businesses don't take these precautions and if creditors aren't paid they will take debt recovery action against you and ultimately, if there are no assets available, the business owner will be forced to file for bankruptcy. (Note: many small businesses finance their business by taking a mortgage on their property, in the case of bankruptcy, this could force the sale of your property at a rate much less than the market rate).

I hope I haven't scared you so far, but businesses that survive this far (90% fail in their first five years) will grow and the money they earn will create a problem for the owner due to being taxed on the years earnings in advance by way of Provisional Tax. At this stage, I usually advise my clients to set up a **Partnership**.

PARTNERSHIP

A partnership is a legal device set up to enable a business owner to distribute income (according to the equity in the business) with the other partner/s. Up to 20 people can be involved in a partnership but the usual scenario is for a husband and wife partnership. This allows the partnership to operate the business and the profit is then distributed to the partners equally. For the husband and wife scenario mentioned above, this is attractive for business operators whose partner is not working; it allows the income to be distributed 50/50 and cuts down the tax that the former sole trader would have normally paid. (See example in table to follow:)

Partnership tax example of income shows:

Taxed as Sole Trader: (2010/2011 Rates)

Profit	**=**	**$40,000**
Tax (including Medicare levy)	**=**	**$ 6,150**

Taxed as Partnership:

Profit	**=**	**$20,000 each**
Tax (including Medicare levy)	**=**	**$ 2,216**
x 2	**=**	**$ 4,432**
Saving	**=**	**$ 1,718**

Currently, if a business is running at a loss, then by distributing some of that loss to a partner who is working elsewhere, results in that partner reducing their tax and therefore getting a refund. (Subject to new restrictions covering business losses from 1/7/2000 which in effect means that a business should have a turnover of $20,000 pa before a loss for the business can be claimed against other income).

Another reason for setting up a partnership is that as the business grows, so does the need for capital to fund the expenses; more equipment, larger premises etc. A sole trader may not have the resources to fund these expansion costs but this can be achieved by admitting a partner who is willing to inject capital into the business. (The amount of capital injected versus the amount of worth of the business determines the percentage of the business the new partner owns).

Similarly, if you are already running a successful, profitable business, by admitting a partner, this is one way of obtaining benefit for part of the market value of the business without selling the business entirely (this happens a lot in accounting and legal practices).

Legal Aspects

Partners are jointly and separately liable for the debts of the business. That is if both partners have resources, then the debts are shared equally. However, if one partner is declared bankrupt, the other partner can be held accountable for the entire debt.

Tax Aspects

To set up a partnership, it is necessary to have some proof of the existence of the partnership e.g. by way of a written partnership agreement or a joint registration of business name. The next step is to make an application to the Tax Office for a Partnership Tax File Number and an ABN. Having established this, one can operate a bank account under the name of the Partnership (by providing the bank with the Partnership Tax File Number).

After receiving the Tax File Number, it is then necessary, after the end of the financial year, to complete a return for the partnership. The partnership itself pays no tax, as the net profit (or loss) is distributed to the partners according to their share of the partnership. The individual partners then declare this distribution in their personal income tax return, along with any other income. Eventually however, the business grows, the resulting profit will cause the partners to pay tax and provisional tax. It is then necessary to commence the next stage of business growth; setting up a **Company**.

COMPANY

Where a business has a profit of more than $80,000 p.a., I advise my clients to set up a company. The reason is that at that point, Company Tax (30%) from 1/7/01 equals personal tax plus Medicare Levy so any income above $80,000 provides a saving of 9.5% (and even more at a personal tax level of $180,000, where the top marginal rate of $46.5% applies(including medicare levy). A company is a separate legal entity to the original sole trader or partners. A business can be "rolled" into a company from a partnership, without triggering off Capital Gains Tax Liability, for the disposal of an asset.

As yet, the biggest problem I have with clients who run a company (typically Mum and Dad companies) is getting them to understand that they are not the company. In this respect, it is vital to have a very clear arms length arrangement for personal expenses versus company expenses. A company bank account is a necessity and to solve the problem of Directors needing to draw on profits or to draw a salary, it is possible for the company to register as a PAYG (Withholding) Payer (- this is the equivalent to the old Group Employer registration); thereby the directors' can legally become employees of their own company. The Company deducts Pay As You Go (PAYG) tax from the salary each week and remits this once a month (or quarterly) to the ATO via the Company's Business Activity Statement. At the end of the year, the company then issues a Pay As You Go withholding Certificate to the employees who then submit this with their personal taxation return and any other income (e.g. interest) that they have accrued.

Legal Benefits

A company can sue and be sued in its own right. If, unfortunately, the company starts to lose money and bankruptcy is threatened by creditors, the only money the creditors can access is the value of the equipment and bank accounts of the company.(In some instances, these assets of the company may only be $2 share capital!). The directors' personal assets are generally not endangered (unless the company keeps trading and the directors know that these funds aren't available to pay the bills, then the directors can be held personally liable).

Other Benefits

Companies have a lot more flexibility of use for business/tax planning.

- For instance, instead of the company directly operating a business, it is possible for, say a Family Trust to operate the business and the company to act as Trustee (thus still achieving the benefits of a company in such instances as bankruptcy and being sued). The Trust, however, can have more flexibility in distributing income to minors (children) and to charitable or religious organizations (which cuts down tax).
- A company has more flexibility as far as Superannuation contributions also; for working directors (i.e. working more than 10 hours a week), it is possible for the company to make Superannuation contributions up to the age based limit:

From 1/07/09 (i.e. 2009/10), a general deductable limit of $25,000 pa applies to all taxpayers (except for those over 50, who can contribute $50,000 pa until 2011/12). (After that date $50,000 p.a. can only be claimed if your superannuation fund balance is less than $500,000).
A company can also act as a Trustee for a Superannuation Trust. (In other words, a company can set up its own Superannuation Fund for directors/employees and can manage the investments instead of leaving this to Insurance Companies to handle).

Fringe Benefits

A company can provide fringe benefits (but the company will have to pay Fringe Benefits Tax on the cost of this benefit. The most usual benefit is a company car. However, often benefits can include reimbursement of expenses (e.g. school fees, travel expenses over $3,000 etc.) In respect to the company car, the Fringe benefits Tax can be minimised by the director keeping a log that shows substantial business use over a twelve week period or by making a contribution for expenses equal to the private use portion of car running expenses.

Accounting & Legal Requirements

A company has to:

- Lodge a Company Taxation Return
- Lodge an Annual Return to the Australian Securities Commission
- Prepare accounts, including Profit & Loss Statements and Balance Sheets using the double entry method of accounting.

Consequently, the running costs of a company are substantially higher; the ASIC fees are $212p.a. and the accounting fees would range from $2,090 upwards (depending on complexity). Note: the directors will still have to submit their own Individual Taxation Returns to include and PAYG (withholding) Certificates from the company and any untaxed directors fees.

EMPLOYMENT ISSUES

I will now turn to a few items that need attention when employing staff, no matter whether as a sole trader, partnership or company. If you have employees (other than yourselves), or even if you have subcontractors who are subject to your direction and control, you must:

- Cover these employees and sub contractors with workers compensation eligible
- You must issue a payslip to employees each pay period.
- You must issue a PAYG (withholding) Certificate by 15th August each year.
- Any employee or sub-contractor who earns more than $1300 per quarter, must have the compulsory Superannuation (9%) paid into a Superannuation fund of his/her choice – either monthly or no later than 30th June (if you wish to claim a tax deduction for the contribution that year). From 01/07/03, it will be compulsory to pay superannuation quarterly and issue a notice of payment to employees.

DEBT COLLECTION ISSUES

In your folders are my Terms of Trade. I didn't include that as a way of attracting potential clients, it is to show that such a document is necessary, particularly for businesses providing services, for it is a fact of business life that you will have clients who don't pay. If you take debt collection against them, it is necessary to prove that they know what your charges are **at the time of engagement**. This can be achieved by giving them a copy of your charges when you first meet, or at least by displaying the charges in your waiting room/office.

That is all I wish to cover about business structures. I will now turn to the other papers in your folder. There are some notes on:

- Records to keep and what to claim for salaried employees.
- Records to keep and what to claim for small businesses

I will briefly explain these items, after which I am available for any questions.

Thanking you for your attention.

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