Fact sheet – First Nations startups

#1 Getting started – legal structures & tax

The legal structure you choose for your for profit startup will have significant consequences as the business grows and upon exit (i.e. sale of assets, sale of shares in a company). Ensuring the best structure is chosen at the start is the best way to avoid costs that may arise if the structure is required to be changed down the line.

Considerations

There is no one 'best' legal structure. By looking at the key characteristics of the most common types of legal structures the owners of a startup can assess the respective strengths and weaknesses of each legal structure in a number of key areas, such as asset protection, ability to raise capital and taxation consequences.

Owners of startups often combine the below legal structures in an attempt to obtain the benefit of the different characteristics of the structures. For example, partnerships can be constituted between companies or trusts (with corporate trustees) and trusts can be shareholders of companies.

	Sole trader	Partnership	Company	Trust
Structure	Simple. No separate legal entity.	No separate legal entity but critical to record how the partners intend to deal with each other (i.e. through a formal partnership agreement).	Separate legal entity. More complex and subject to more regulation than other entities.	No separate legal entity. A trust is a relationship between two or more people under which legal title to some specific property (trust property) is separated from beneficial ownership of that property. The 'Trustee' is the person or entity that holds legal title to the trust property. The 'beneficiaries' are the beneficial owners of the trust property.

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	Sole trader	Partnership	Company	Trust
Costs involved	Inexpensive to set up. Must have a business name (if not using own name) & be registered for GST.	Relatively inexpensive. Few regulatory requirements.	More expensive to set-up and to maintain than other legal entities.	Relatively inexpensive.
Liability	Single business owner is personally liable for debts & liabilities of business. Creditors may pursue a sole trader's private assets for debts owed.	Partners are jointly and severally liable for debts and obligations of the partnership (irrespective of the partner that incurred the liability).	Assets used in the business are owned by the company, separate from private assets of the business owners. Shareholders are not liable for the debts and obligations of the company, but directors may be personally liable for the company debts in some circumstance, for example, if they operate the company while insolvent.	The trustee has an equitable obligation to deal with the trust property for the benefit of the beneficiaries. The trustee is personally liable for transactions under the trust and will also be entitled to be indemnified out of the assets of the trust (provided it is acting in accordance with its obligations as trustee). Often a company acts as trustee of the trust to provide asset protection benefits.
Profit distribution & tax	Business income is reported on an individual's tax return. Profits of the business are taxed at the individual's personal income tax rate.	Profits are split in accordance with the agreement between the partners (or the partnership law) and are taxed at the hands of each partner individually. Despite this, there is still a requirement to lodge a tax return for the partnership.	Ability to raise capital (including through shareholders). Profits taxed at the company rate (likely 25%, unless the aggregated turnover is over $50mil – in which case the tax rate will be 30%). Profits are distributed by way of dividends to the shareholders or retained in the company. Where profits are distributed, shareholders may receive a franking credit for tax paid by the company.	The two main types of trusts are unit trusts and discretionary trusts. In a unit trust, the beneficiaries have a fixed entitlement to income and capital based on the proportion of units they hold in the trust. The ability to issue further units gives unit trusts the ability to raise capital by introducing further unitholders. In a discretionary trust, the trustee has discretion to distribute income and capital to one or more beneficiaries as the trustee sees fit (which may have tax benefits). Profits are taxed in the hands of the beneficiaries unless the trustee fails to distribute profits and then the trustee is taxed at penalty rates.

Please see our other Fact Sheets for First Nations startups here.

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Disclaimer

The content of this fact sheet is current at September 2024 and is intended to provide a general guide to the subject matter only. The fact sheet does not constitute legal advice. Obtaining specialist advice about your specific circumstances is recommended.