

Which Business Structure?

This helpsheet gives you an outline of the different business structures you can trade through. Your business format is not set in stone forever and you can change between them. It is fairly simple for a sole trader to take on a partner and become a partnership and for a partnership to become a Limited Company. There are however more complications with changing from a Limited Company to a sole trader or partnership.

Sole Trader

This is the simplest form of business to start where you carry on business on your own account. You are liable to income tax and Class 4 National Insurance on your profits. You can employ people including your spouse, as long as they are paid only for the value of work actually performed.

Partnership

A partnership is two or more people carrying on business together with a view to making profit, although partnerships can also be formed between companies, or between an individual and a company.

The partners in a general partnership are all joint and severally liable for partnership debts, although this does not apply to personal tax bills based on partnership profits.

It is advisable to have a partnership agreement to document the business arrangement between the partners, including how profits will be shared and how partners will join and leave the partnership. Even a husband and wife partnership should have a written partnership agreement, as this can be used to show the Revenue that both parties are actively involved in the business and have a right to share the profits.

Limited Company

A limited company is a separate legal entity from its owners. These are the basic facts...

1. The business is owned by the limited company, not you.
2. The company must have at least one shareholder.
3. It must also have at least one director and as Company law has changed, small companies will no longer be required to have a company secretary.
4. The shareholders do not have to be directors. Directors are treated as employees of the company, but they do not have to draw a salary from the company.
5. If you are the only shareholder, you will have sole ownership of the company, and are likely to also be the director who runs it.
6. The company pays corporation tax on its profits.
7. The company is governed by company law.

Main advantages of using a Limited Company

1. A Limited Company may appear more credible and substantial although in reality this is not necessarily the case.
2. The liability of its shareholders is limited to the amount of the share capital issued and so offers protection to the shareholders' personal assets. In the event of company failure and not being able to pay its creditors, your personal assets are protected. However, banks, landlords and others will often require personal guarantees from the shareholders or directors when dealing with small limited companies.
3. A Limited Company has better borrowing potential than an unincorporated business as it can use current assets as security by creating a floating charge over its assets.
4. You can use shares to enable different people to hold different proportions of ownership of the business that they can pass onto the next generation.
5. You can have different classes of shares with different rights, such as non-voting shares for someone who wants to invest some money into the company but doesn't wish to take part in the management.
6. Having a limited company can create significant tax advantages by having profits taxed at Corporation Tax rates which are a low lower than the higher rates of personal tax. However when the funds are extract from the company extra tax or national insurance charges may arise.

Main disadvantages of using a Limited Company

1. Your annual accounts have to be filed at Companies House and are available for public inspection as is other information about the company.
2. Directors are personally subject to regulations and can be fined or found guilty of a criminal offence for failing to comply.
3. A company is more complicated to wind up.
4. Any losses made by the company cannot be used against the owner's other income.

Many of the costs associated with managing and operating a limited company are no longer much greater than a non-limited business. Accountants and other professional advisers often have conflicting views on when they consider the benefits of being limited to outweigh the advantages of being self-employed. In general terms, at least from the perspective of taxation and accountancy, changes to legislation over the last few years have meant much lower costs associated with limited companies.

There is no obligation for a limited company to commence trading within any set time period after its incorporation. This means that the formation of a limited company is one simple and low cost method to protect a business name. Whilst this does not in itself give any rights to use of the business name, many clients form companies in anticipation of future

development of new businesses or in order to protect the limited company name of an existing non-limited business for the future. Remember, no two limited companies can exist with exactly the same name.

Limited Liability Partnership (LLP)

LLP's are treated like a normal partnership for tax purposes but the members of the partnership the protection of Limited Liability.

A LLP is a separate legal entity and can enter into contracts and deeds, sue and be sued in its own name. With normal partnerships every partner has to be party to certain documents and litigation.

Floating charges can be granted over its assets in its own name, which normal partnerships can't do. As with Limited Companies, the LLP must file annual accounts at Companies House together with certain other information.

Conclusion

The best business structures are those that are as flexible as possible. A new business that is likely to make losses in the first few years could start as a partnership or sole-trader to make the best use of those losses. There may be commercial pressures to operate as a limited company in certain sectors. It is possible to split a business into two ; one part running as a Limited Company and one as a sole trader/partnership to get the best of both structures. However the VAT implications of such a split must be considered carefully. You can even structure the business as a partnership but with one of the partners being a limited company.

Your accountant can assist in advising on the most appropriate business structure for you, giving consideration to both commercial and tax issues. It is important to get this right from the beginning.