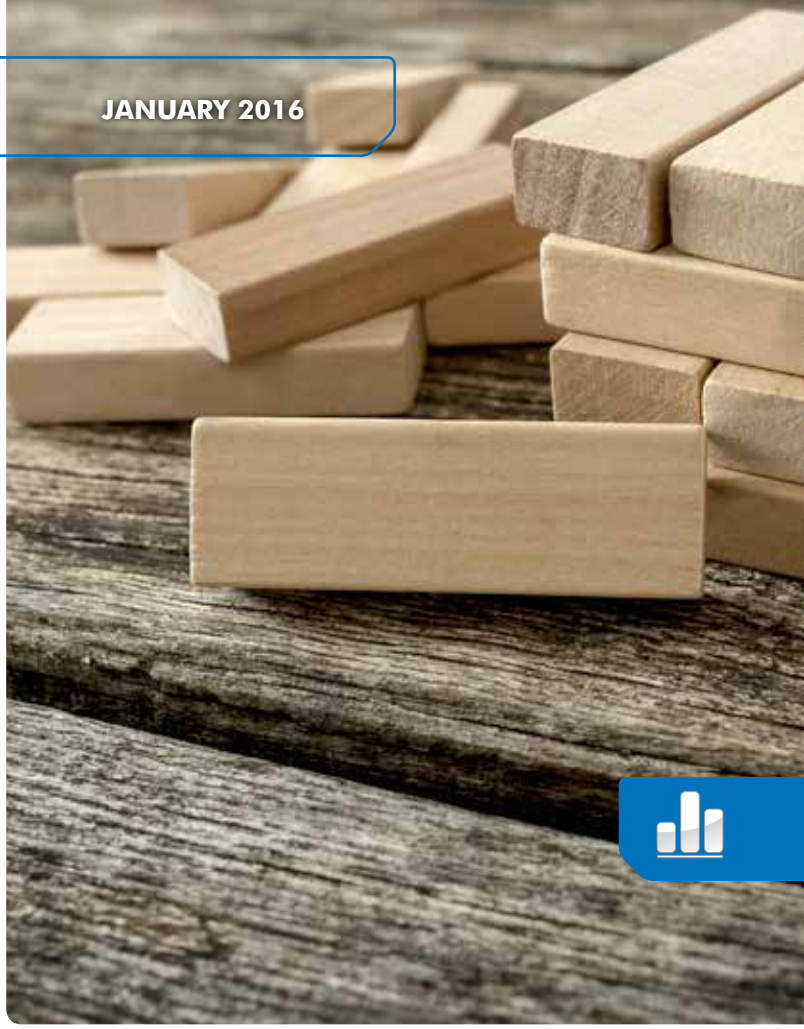

Choosing a business structure

An introduction to the most common types of businesses: sole traders, limited companies and partnerships.

After the start of a brand new year, changing something about the way you do business can make you feel like you've turned a new page. This could be anything from launching a new product or service, redesigning your company logo to ordering new office stationery.

Switching your business's structure is one such way of changing the way you do business. Sole traders, having recently struck up a good relationship with another like-minded individual, might be thinking about entering a partnership. Having eyed up the potential tax advantages, existing partnerships may be looking into the process of incorporation.

However, changing the structure of your business is not something that should be done on a whim. Uprooting a business from its foundations can have dramatic effects if your planning is insufficient or if there are no tangible benefits to changing in the first place.

Before you embark on any structural changes, you should ask the question: is this really necessary?

Becoming a sole trader

Working as a sole trader represents the most rudimentary form of doing business. There is minimal paperwork involved, organising tax affairs is simple (at least compared to limited companies) and there are few statutory obligations to meet.

Things get slightly more complicated if you earn more than £82,000 a year, at which point you'll need to register for, collect and pay VAT.

Employing other people will also mean that you'll need to set-up suitable payroll infrastructure and submit separate returns.

The degree of freedom attracts many to the idea of being a sole trader. You are your own boss, and you alone control the direction of the business. The downside is that you are solely responsible for your business's liabilities; if debts remain unpaid or if you make significant losses your personal assets will be at risk.

Contact us today to talk about sole trading.

Forming a limited company

Incorporating your business is an entirely different process to setting up as a sole trader. The opportunities for tax planning are more comprehensive but administration can be complex and there are additional regulations to comply with.

A limited company is owned by its shareholders and run by its directors. Unlike sole traders, a limited company is legally separate from its owners. Directors therefore only take on limited liability, meaning that they are only liable for what they have invested in the business.

Compliance with the Companies Act can seem intimidating for those thinking about incorporating their business. After registering with Companies House your business will need to:

- file and maintain statutory accounts
- pay corporation tax, PAYE and national insurance (NI) bills
- file VAT returns if applicable
- comply with auditing requirements (if your business is above the small business auditing threshold).

While limited companies face the additional burden of corporation tax, various tax reliefs are able to mitigate this and extracting profits via dividends and salaries can lower exposure to income tax and NI for directors and shareholders.

Contact our team about limited companies today.

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Entering a partnership

Partnerships offer an alternative for those who want to go into business with other people, but don't want to set up a limited company.

Running the business and paying tax are responsibilities shared by partners, as are the profits. Partners pay income tax and NI on their individual shares of the profits, and each partner must send separate self-assessment tax returns.

There are 3 main types of partnership:

Business partnership

Business partnerships (also called 'ordinary' partnerships) are the simplest way for 2 or more people to go into business together. All partners in a business partnership are personally liable for losses incurred by the business.

Limited partnership

In a limited partnership (LP), debt liability is unequally shared among partners who fall into 1 of 2 categories: general partners and limited partners.

General partners are those with primary responsibility for managing the business and take on personal liability for all of the business's debts.

Limited partners are only liable for their initial investment in the business.

Limited liability partnership

Limited liability partnerships (LLP) function also allows partners to assume limited liability on unpaid debts; they will not be held personally liable for the business's debts, only for the money they have put into the business.

LLPs are more complex and cost more to set up than other types of partnership; limited liability means that you will need to maintain accounts and submit them to Companies House and a legally-binding LLP agreement will need to be drawn up by a solicitor.

There are different rules for Scottish partnerships.

Contact us for further information.

Sole trader vs partnership vs limited company

	Sole trader	Partnership	Limited company
Tax	Tax planning opportunities for sole traders are minimal. As a result, they often face proportionally higher personal tax bills.	Partners pay tax in the same way as sole traders and face similar tax planning limitations.	Opportunities to reduce income tax and NI liabilities mean that company directors often pay less personal tax.
Liability	Sole traders bear unlimited liability for their business. There is no legal separation between you and your business.	This depends on what kind of partnership you have set up and, if you are part of an LP, whether you're a general or limited partner.	Limited company directors have limited liability. Business assets are seen as separate from those of the directors, reducing the personal risk.
Administration	Administration for many sole traders is limited to submitting an annual self-assessment tax return. However, if you are VAT-registered and employ other people, you will also need to file VAT and payroll returns.	Each partner must submit a self-assessment return, and pay their NI and income tax bills. Like limited companies, LLPs must submit audited annual accounts, maintain statutory records and submit an annual return.	Meeting the requirements of the Companies Act, complying with statutory audits and submitting multiple tax returns makes administration far more complex for limited companies.
Extracting profits	As there is no personal-business separation, sole traders do not need to extract profits. Money is paid directly to you and your profit is everything that remains after you've paid tax.	For the same reasons as sole traders, partners do not need to extract profits.	Company directors and shareholders must extract profits from the business. The 2 most common ways of doing this are with salaries and dividends which are then taxed and/or have NI deducted.
Privacy	Sole traders are not obliged to publish their business's financial and accounting details, allowing you a greater degree of privacy.	Business and LPs are not obliged to make public their accounts and financial information. However, LLPs must submit accounts to Companies House for public record.	In order to comply with the Companies Act limited companies must release financial and accounting information to the public, reducing your privacy.

This guide has provided an introductory overview of the main differences between common business structures, and should not be the sole basis of your final decision. Your situation should be professionally assessed and proper expertise should be sought before you decide to change your business's structure.

Contact us for further information.