Factsheets No.3

Business structure – which should I use?

You have made the decision to become your own boss, it is important to decide the best legal and taxation structure of your new enterprise. This will depend on your personal situation and your future plans. It is an important decision as it will have repercussions on the way you are taxed, your exposure to creditors and other matters.

Sole Trader – this is the simplest way of trading. There are only a few formalities to trading in this way. The most important is informing HMRC. You are required to keep business records in order to calculate profits each year. These records will form the basis of how you pay your tax and national insurance. Profits generated are automatically yours. The business of a sole trader is not distinguished from the proprietor's personal tax affairs, consequently any debts you incur, and you will be legally liable to pay those debts down to your last worldly possession.

Partnership – are an extension of being a sole trader. A group of two or more people will come together, pool their talents, clients, and business contacts to that, together they can build a more successful business than they would individually. The partners will agree to share the joint profits in pre-determined percentages. It is advisable to have a partnership agreement drawn up by a professional which sets out the rules of how the partners will work together. Partners are taxed the same way as sole traders but only on their portion of the profits. Partners as with sole traders are legally liable to pay the debts of the business. Each partner is jointly and severally liable for partnership debts, so that is certain partners are unable to pay their share of the partnership bets then those debts can fall on the other partners.

Limited Company – these are separate legal entities from their owners. Companies can trade, own assets, and incur liabilities in its own right. Ownership of a company is recognised by shares in that company. If you also work for the company, you are both the owner (shareholder) and an employee. When profits are generated they are the property of the company. To extract money from the business you should either pay a dividend or a salary as an employee. An advantage is that you can have a balance of the two to minimise your overall tax and national insurance liability. Companies themselves pay corporation tax on their profits after paying your salary but before your dividend distribution. There are additional administrative factors in running a company, such as statutory accounts preparation, company secretarial obligations and PAYE (pay as you earn) procedures. The advantage of owning a limited company is that your personal liability is limited to the nominal share capital you have invested.

Limited liability partnership – is legally similar to a company. It is administered like a company in all aspects except its taxation. In this, it is treated like a partnership. Therefore you have the limited liability, administrative and statutory obligations of a company but not the taxation and national insurance flexibility. This structure of business is suitable for medium to large sized partnerships.

Co-operative – is a mutual organisation owned by it's employees. One example of such is John Lewis Partnership. These structures need specialist advice.

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