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QUICK GUIDE NOTES – help on Selecting the Right Business Structure for you

You're ready to start your new business, so now you need to consider the type of business structure and here we'll focus on the most commonly chosen routes. Having looked at the options, it's a good principle to start out with the simplest structure your business plan will allow. You can easily change to a more sophisticated model as the business scales up. The usual options are **Sole Trader, Partnership or Limited Liability Company**. The main attributes of each are summarized below.

The advantages of registering as a sole trader

- There are no dues or fees to register
- You can go straight out and order your business cards.
- Most new businesses are set up this way – it is easy
- It is inexpensive
- There is very little in the way of red tape.

While a sole trading business can, and do, employ staff, the majority are one-man-bands, and most operate in service sectors, such as photography, hairdressing, construction and business-related services.

Any decisions are yours alone and can be acted on at once and all the profits are yours.

The disadvantages of registering as a sole trader

- It's important to remember that the law makes no distinction between your business and you as its owner. This means that liability is unlimited, meaning any business debt can be met from the owner's personal wealth if the business fails.
- As a sole trader, your profits are taxed as income by HMRC, and as you are self-employed, your tax will be self-assessed. But you should be no worse off than you were as an employee.
- It's also important to remember that many expenses such as business travel and some cost of your premises, even if you are working from home, are tax-deductible. You will have to register for self-assessment with HMRC and fill in a tax return each year, but the paperwork more or less ends there.

When and why should you register as a sole trader?

If yours is a low-cost start-up and you are not likely to need to borrow to grow the business then this may not matter too much, but it can't be stated too many times that as a sole trader you alone pick up the bill for any commitments made in the name of the business.

Being a sole trader can be a lonely and exposed position. The advantage of being your own boss is counterbalanced by not having anyone to validate your path. You are liable for debts, but also future liabilities. If you are sued you might go bankrupt: as with personal debt your assets – your house and family – are exposed.

It's when the business starts to grow that the problems emerge. Since your profits are taxed as income you will be paying 40% as soon as they top £41,865 and 45% above £150,000. So taxation is a risk, but even greater is the risk of liability.

Is a partnership for you?

A partnership is for you if you are offering services with people you know well. Many building and domestic services firms are either sole traders or partnerships, but bear in mind that if you hope to gain sub-contract work from larger companies you may need to incorporate to satisfy their guidelines.

Partnerships are a very common extension of the sole trader model, for example when two individuals or a husband and wife work together to build the business. The partnership is just as flexible, has the benefit of two or more heads, and the business won't collapse if one of you is sick or needs a holiday.

There has to be an agreement as to how the liabilities, ownership and profits of the business are split and what happens if one partner wants to leave, which should be enshrined in a partnership agreement. However, the only legal requirement, as with a one-person business, is that each partner is registered as self-employed and puts in a separate tax return.

In a standard partnership, as with sole traders, all partners are also responsible for all the debts owed by the business. This doesn't only apply to debts you have incurred as a partner but to those of any partner, so you need to pay particular care to the conduct of the people you go into business with.

Incorporating a limited liability company (Ltd)

Incorporating means registering a limited company or LLP at Companies House: it's a move that will lend credibility to the business. It may also make it easier to borrow money when the time comes. But do look carefully at your motives: being the managing director of a limited company may bring status, but you may regret the move when struggling with the year-end accounts.

Once you register at Companies House as a private limited company you are letting yourself in for more administration. But it is not as daunting as it used to be – these days you can be the sole shareholder and director, and act as company secretary too (although appointing a company secretary is no longer a legal requirement).

Most private limited companies are owned by their shareholders and are limited by shares. This means that the face value of their share in the business is the most they can be called on to pay if things go wrong.

The great advantage of limited liability is that you can control your exposure to financial risk. There's a firewall between your money and the company's. This is because a limited company is a separate legal entity to the company directors, therefore it is the business itself that shoulders the financial liability if the business goes under. Your home, your family and your lifestyle are protected.

The tax regime is more favourable to a registered company than to a sole trader. Limited companies pay corporation tax on their profits and their company directors are taxed as employees in the same way as other people who work for the company. The UK corporation tax rate is 20% for the year beginning 1 April 2015. But in a limited company profit there is also a firewall between profit and your income: you will have to pay income tax on the salary the business pays you.

Once you are trading, you will be required to submit full statutory accounts and a company tax return to HMRC each year, as well as making monthly or quarterly payments of employees' income tax (PAYE) and NICs.

You will also have to file statutory accounts and an annual return to Companies House, although small and medium-sized companies (with a turnover of less than £5.6m) can submit an abbreviated version.

Before you can start trading, you need to officially register your limited company, decide on the company officers and choose a name for your business. Then, once you've filed the correct documents with Companies House, you are ready to go.

Business legal structure checklist

Structure	**For**	**Against**
Sole Trader	Low cost, easy to set up Full control retained Very little financial reporting	Full liability for debt Possibly pay more in tax May lack credibility in market-pace
Partnership	As above, but with more people More potential to raise finance	As above, affecting all partners Can be messy to wind up
Limited Company	Less personal financial exposure Favourable tax regime Ability to work for corporate clients	Administrative and regulatory demands heavier Annual accounts and financial reports must be placed in public domain