Larking Gowen

Committed to you.

Helping new businesses choose the right structure

What business structure is right for your business?

When you're getting your new business off the ground, the first thing to consider is what structure to trade as – sole trader, partnership or limited company. Use this guide to understand the pros and cons of each and make the right decision.

Sole trader

When you work as a sole trader, there's no legal division between you and your business. Therefore, if there are bills to be paid, you'll personally be liable for these. For reporting purposes, you simply keep track of the money coming in and out, complete annual accounts, a personal tax return and pay tax on your profits.

Partnership

A partnership is where there are two or more partners running the business together. As with a sole trader, the partners are jointly responsible for the business debts. The reporting requirements of a partnership are similar to a sole trader, with the addition of a partnership tax return.

Limited company

A limited company is a legal entity owned by shareholders and run by directors. In comparison to the other two structures, the company is liable for its own debts, creating more legal protection for you as an individual. There's more paperwork involved, which is usually more expensive, but also allows many more options in terms of paying yourself and succession planning.

It's worth noting...

If you choose to start your business as a sole trader or partnership for ease, and then your business grows to a size that proves a limited company would be a more beneficial option, you can incorporate at a later date.

A limited company is the only structure of the three which provides its owners some protection from legal actions by creditors.

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Tax

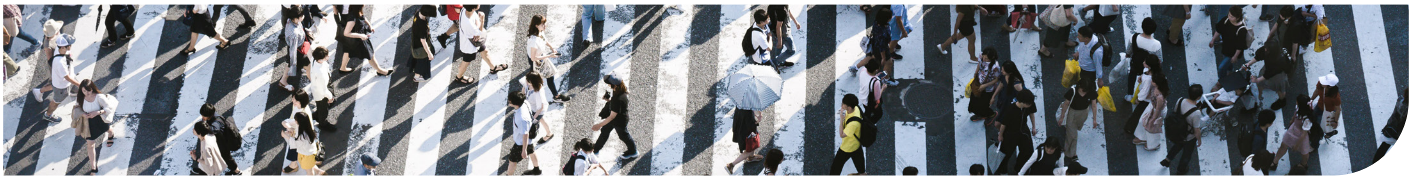
This depends on your individual circumstances and how much profit you expect to make, taking into account the costs of being a sole trader or partnership versus a limited company. In general, the higher your profits, the more likely it is that a limited company will be right for you.

Loans and finance

As a brand-new company, you might find it hard to get a loan without a personal guarantee from a director. In terms of commercial risk, the situation could actually be quite similar for both sole traders and newly formed limited companies. However, where any borrowings are going to be significant, the impact of tax relief can have a direct correlation on the commercial structure you choose.

Payroll

All types of business can take on staff and run a PAYE payroll, so this doesn't affect your choice of structure. However, the owner-managers of a company will be taxable as employees and therefore subject to the rules on benefits in kind, which can prove costly.



Paperwork and costs

There are more legal requirements surrounding a company than with a sole trader or partnership. You'll need to submit annual accounts to Companies House which conform to strict regulations, along with a company tax return to HM Revenue & Customs (HMRC). You'll also need to file an annual confirmation statement to Companies House and your own personal income tax return as a director of the company.

By comparison, the only filing requirement for a sole trader is the individual's personal income tax return, reporting the profits of the business each year along with any other income.

A partnership is similar but involves one additional return for the partnership itself.

Paying yourself

As a sole trader or partnership, you can access the profits and withdraw funds whenever you like, although you should not withdraw more than the accumulated profits of the business.

As a company, the business is a separate legal entity so it may take a little more thought to be sure the profits are being extracted in the most tax efficient way.

As an officer of the company, you'll be taxed as an employee and any salary will be taxed through the PAYE system and subject to National Insurance.

Investors in companies can be rewarded by means of dividends.

VAT

If your sales total more than £85,000 in a 12-month period, you will be required to register for VAT. Some businesses choose to register for VAT even though their sales are below this level so that they can recover the VAT they incur on purchases.

We can help you decide whether you need to register for VAT and advise on how to account for, report and pay your VAT. We can help you consider any VAT schemes which could be advantageous to your situation.

VAT applies to all three structures in the same way, so you can take the same approach to VAT regardless of which structure you choose.

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