

Choosing an Appropriate Business Structure



Sole Trader: This is the easiest way to become self employed. The set up requirements are minimal – all you need do is register with HM Revenue and Customs. Ongoing - you are required to submit annual accounts to HMRC which determine your profits (or losses). National Insurance and Tax are calculated on your profits.

All of the profits are taxed on you personally, which means that you will be paying tax at the highest rate that can be charged against you.

Your personal assets are treated as your business assets because you don't have limited liability (not a Limited Company). This could be significant if your business gets into financial difficulties. You could also find it difficult to attract financial investment because an investor might perceive that a Sole Trader cannot offer a money making vehicle in the same way as a Limited Company can. Being a Sole Trader is only suitable therefore for a business which is not subject to a lot of risk.

Partnership: This is where 2 or more people form and run a business together. It is very similar to the Sole Trader set up in that the registration and running requirements are very simple.

A significant factor would be that each partner is subject to liabilities (jointly and severally liable) that are not limited. Your personal finances and assets could be at risk through poor decisions made by your partner.

A Partnership agreement would say what percentage of profit each partner receives and each partner will be taxed at whatever is the highest tax rate applicable for them personally. The strength of a good Partnership relies on the partners continued relations and trust in each other's decisions and actions.

Another form of Partnership is called a Limited Liability Partnership (LLP). Here the potential losses of the partners are limited to the assets of the business.

Limited Company: This is a legal entity which is separate from its owners. This means it can trade / own assets (such as offices and equipment) and it can incur liabilities in its own right. Therefore if the Company has financial difficulties, the personal assets of the owners are not at risk.

Whatever cash or investment the Company has is at risk. It is limited to whatever the Company owns (assets) and cash in the Company bank account.

The way companies are taxed means that not all profits are automatically taxed at the highest rates. For instance, the Company itself pays corporation tax which is a lower rate than the individual higher rate tax bracket. A Company can choose to pay profits (dividends) to the owners at a time which suits their personal tax situation. This 'sheltering' means that some profit can be held back in the Company bank account until it is needed. This would defer a tax liability until later on. These are complex issues which usually require the assistance of an accountant.

The forming, registration and running of a Limited Company are more demanding than setting up as a Sole Trader or in a Partnership. This is due to the requirement to comply with the rules set down by the Companies Act.

Freelance Contracting: The law states that someone gaining work through an agency must either be paid through the agency payroll or work through a Limited Company.

Generally a Freelance Contractor will work through a Limited Company (see above). However, the tax payable is affected by the IR35 Rules and a Contractor must decide whether they work like an employee. For instance being instructed on what work to carry out and being supervised in their work (= fail IR35), or whether they work more like a consultant, and are in business on their own behalf (= pass IR35).

There is a great deal of documentation available describing IR35 and the rules of 'Contracting'. If you would like to discuss this however, please call us on 01793 818400.