

Know which is the right business format for you

The road to success in business begins with choosing the right business format. You need to plan well ahead for the future, deciding how your business might develop. It is thus important that you understand the advantages and draw-backs of the various business formats and spend a little time considering which is best suited for your venture. Your four main options are:

Sole trader

Sole trading is the most common form of ownership in the UK and the simplest way to get started in business. Once you have informed the government agencies of your intentions to go self-employed, you can start trading right away (subject to any specific licences you might require in your line of work).

As a sole trader, you are ultimately responsible for any liabilities should anything go wrong in the business. A sole trader is liable for any debts that the business incurs. This means that any money that the owner has put into the business could be lost, but importantly, if the business continues to incur further costs then the owner has to pay these as well. In some cases they may have to sell some of their own possessions to pay creditors.

However, sole trading also offers minimal bureaucratic chores and complete control over your business and accounting affairs. Many will prefer the satisfaction of running a business with little paper work against the risks, pressure and probably long working hours.

As a sole trader, you can have one or more employees.

If you are a sole trader, your business income is counted alongside your existing personal income. You will need to submit an annual self assessment form to the Inland

Revenue and keep accurate and up-to-date records of all business transactions and accounts. You will also pay income tax on all profits and pay national insurance contributions on those profits. Losses can be offset against tax on other income.

If you're already paying NI contributions in another job, you may be able to defer paying your Class 2 contributions until the end of the tax year.

The main advantages of setting up as a sole trader are:

- Total control of the business by the owner.
- Cheap and easy to start up – few forms to fill in and to start trading the sole trader does not need to employ any specialist services, other than setting up a bank account and informing the tax offices.
- Keep all the profit – as the owner, all the profit belongs to the sole trader.
- Business affairs are private – competitors cannot see what you are earning, so will know less about how the business works and how it succeeds.

The main disadvantages of being a sole trader are:

- Unlimited liability – see below.
- Can be difficult to raise finance, because they are small, banks will not lend them large sums and they will not be able to use any other form of long-term finance unless they change their ownership status.
- Can be difficult to enjoy economies of scale, i.e. lower costs per unit due to higher levels of production. A sole trader, for instance, may not be able to buy in bulk and enjoy the same discounts as larger businesses.
- There is a problem of continuity if the sole trader retires or dies – what happens to the business next?
- you are also fully liable financially, and the need for your business to examine the implications and consequences of bankruptcy or loss of personal possessions due to the sole trader accepting unlimited liability must also be considered. The larger your business becomes, the greater the risk will be.

Setting Up

As a sole trader, you will not need to notify Companies House, nor deal with any administrative or accounting requirements which are required of Limited Companies.

If you start working for yourself, you must register with the Inland Revenue as self-employed (Tel: 08459-154-515), even if you already send in a tax return. There are some exceptions and special rules for particular industries, like the construction industry. If you're not sure whether you need to register as self-employed, read the leaflet entitled: IR56 - employed or self-employed (PDF Format).

Once you've decided to become a sole trader, and have informed the authorities, you should think about taking out the appropriate business insurance cover for your new venture. You may need to take out Public Liability and Employers Liability as well as insurance specific to your trade.

As a sole trader, you can open a business account to enable you to keep a separate account to your personal one. The choice is up to you.

Other Considerations

The limited company route limits the personal liability of its directors if something goes wrong, whereas the sole trader is ultimately personally liable for any losses the business makes, or if you are forced into bankruptcy. Also, in some areas of business, having a limited company setup will enhance prestige and provide a more professional appearance in certain industries. You can of course always start out as a sole trader, and then incorporate at a later date, if you choose to.

Limited Company

A limited company is a separate legal person created by incorporation at Companies House. Its profits, losses, assets and liabilities are its own. The company is owned by its members (the shareholders) and run by the director (or directors) whose assets are protected from loss if the business should fail. This gives the directors Limited Liabilities; e.g. should the company fail, the directors personal assets are protected and the people

who own the company will only be required to pay what they have already paid or agreed to pay towards settling its debts.

Because a company has a life of its own the business can continue despite the resignation or death of any directors or shareholders and can be sold to new owners.

The main advantages of setting up as limited company are:

- The debts and contracts are owned by the company
- A registered company exists until it is wound up. It is not affected by death, bankruptcy, mental disorder or retirement of any of its members.
- The property of a registered company belongs to and is vested in the company. It is not affected by change of ownership of shares in the company.
- Subject to any restrictions in the articles, shares in the company may be transferred easily or mortgaged without the consent of the other shareholders.
- Liability in the case of a company limited by shares is limited to the amount unpaid on the shares held.
- Management of the company can be separate from ownership and therefore provides continuity after shareholder changes.
- The taxation of registered companies is often more 'flexible' than other forms of business. A Limited Company is liable only for tax on its profits after all expenses are deducted. It is not subject to personal taxation (which is usually a higher rate).
- Capital, to fund the company, may be obtained with relative ease when compared to other business types.
- As a registered company, you to conduct business in the UK and/or under English law even if you are foreign national or business.

Setting up a limited company

First, check the availability of your proposed company name using the free name checking service at Companies House, and submit the required documentation

(www.companieshouse.co.uk). Once incorporated, Companies House issues a certificate and company registration number. You can change the company's name at any time and keep the same registration number.

Partnership

If two or more people wish to go into business together, but without going down the Limited Company route, a partnership offers a simple way to get started.

Partnership has no legal status, it is merely a vehicle linking two or more self-employed people in a simple business structure. Essentially, each of the partner's business income is counted alongside their existing personal income, so the administrative side of your business is very straightforward.

You will not need to notify Companies House and there are no specific administrative or accounting requirements. Partners are personally liable for any debts incurred in the running of the business

The main advantages and disadvantages of partnership

They are very similar to those of a sole trader, but here are some additional points:

- You don't need a written agreement to form a partnership but it is wise to have one drawn up and checked by a solicitor.
- Unless your Partnership Agreement specifies otherwise, partner will have to share equally the capital and profits of the business.
- Unless your Partnership Agreement specifies otherwise, either of the partners can withdraw immediately, without giving notice.
- Partners are each responsible for business debts incurred by other partners - even if these are not agreed
- You can find yourself unwittingly in a partnership if you run a business with somebody but don't employ them (often the case with husbands and wives).

There are five main types of partnership:

- Equity partners contribute capital to the business and share in the profits/losses;
- Salaried partners receive a salary but are unlikely to contribute capital;
- Sleeping partners take no part in running the business, though they may contribute capital and receive a salary;
- Limited partners, where the liability of one or more (but not all) partners is limited to the amount of capital they invest. Limited partners must be registered at Companies House;
- Limited liability partnerships (LLP; see below) where the business, not the partners, have legal liability to third parties. This type of partnership must also be registered at Companies House.

Setting up a partnership

Each partner will need to inform the Inland Revenue that they are now self employed. You will then submit an annual self assessment form to the Inland Revenue and keep accurate and up-to-date records of all business transactions and accounts. You will also be pay income tax on all profits and pay national insurance contributions on those profits.

The partnership itself will also have to submit an annual self assessment form as well as each partner.

It is worth bearing in mind that if either of the partners withdraws from the business (if they die, resign or go bankrupt), the partnership must be dissolved instantly, since it has no legal status.

Limited Liability Partnership (LLP)

It is an alternative corporate business vehicle that gives the benefits of limited liability but allows its members the flexibility of organising their internal structure as a traditional

partnership. The LLP is a separate legal entity and, while the LLP itself will be liable for the full extent of its assets, the liability of the members will be limited.

Individuals or existing businesses can be members of a Limited Liability Partnership, and the LLP must have at least 2 members. The rights and responsibilities of all members would usually be laid out in a "Deed of Partnership".

A LLP is considered an association of co-owners for tax purposes, and each co-owner is taxed on his or her proportional share of the LLP profits. An LLP is similar in some ways to a standard Partnership, except that the individual members have lower liabilities to any debts which may arise from running the business.

In a LLP all partners must consent in sale of the assets of the partnership. A partner's interest in a LLP is considered personal property that may be assigned to other persons, but if so transferred the transferee only receives the financial benefit and does not become a partner.

Advantages of an LLP

- LLP's do not have the corporate procedures of annual meetings and minutes.
- The LLP is not a separate taxable entity, but instead the profits pass through to the partners who pay for them as income tax.
- LLP offers protection from personal bankruptcy and from a rogue partner acting without authority, with all the tax advantages of trading as a partnership

Disadvantages of an LLP

- The LLP is itself liable for debts run up in running the business, rather than the individual members of the LLP. As a result, LLP's are only recommended for profit running businesses.
- Any partner without the other may bind the LLP.
- Money and property contributed to the LLP becomes owned by the partnership unless otherwise stated and the contributor is not entitled to its return except as stated in the partnership agreements.

- Every partner is jointly and severally liable with the other partners for all the firm's debts and obligations incurred while he/she is a partner.
- There are more administrative duties involved compared to the Partnership

Setting up a LLP

To incorporate an LLP, you should contact Companies House and fill in an incorporation application form. You also need to draw up a "Deed of Partnership" at the time of formation. This deed is a legally binding agreement between members which lays out the rights and responsibilities of each party to the agreement, the details on the amount of capital each partner will inject into the business, what their individual roles and responsibilities will be in running the business and what would happen if a partner leaves the business.

Since all profits in the LLP are split between the members, tax liability falls on the individual members, not the LLP itself. Most members are likely to be self-employed, so all income should be declared via self-assessment. If the LLP member is a business (rather than a person), this company will be liable to pay corporation tax on any income they receive from the LLP.

If the LLP is expecting to generate income of above the VAT registration threshold, they must register for VAT. If the LLP has employees, it should also set up a PAYE system to collect income tax and National Insurance contributions.

A member of the LLP must be "nominated" to act on behalf of the LLP to liaise with the Inland Revenue, file tax and other returns.