Calderdale Council

Resource 2

Business Structures Guidance

** Limited liability is where a person's financial liability / risk is limited to a fixed sum, usually a minimal amount. Partners in a limited partnership or company are not personally liable for any debts of the company, where they have acted in good faith.*

Sole Trader

The simplest way of operating a business is as a sole trader, otherwise known as being self-employed.

You need to inform HMRC of your intentions to become self-employed and will have to complete a self-assessment tax return each year. Any profits can be taken as 'drawings' and will be treated as a salary on your self-assessment tax return. You will pay income tax and Class 2 / 4 National Insurance Contributions on any profits your business makes and you must ensure you have funds available to pay whatever tax is due once your return is submitted.

Sole traders do not have limited liability in case something goes wrong, so for example any business debts you incur will be counted as personal debts. However there are insurance policies that will cover the 'unlimited liability' risks, such as Professional Indemnity Insurance.

Partnership

Two or more self-employed individuals may decide to work together and set up a partnership.

As with sole traders, partnerships do not enjoy the benefit of limited liability. The partners will share in all aspects of the business – both in terms of any profits the partnership makes, but also in terms of liabilities.

It is very important that you enter into a Partnership Agreement if you decide to form an informal partnership. The agreement should cover all aspects of how the business will be run, how any profits will be split and what will happen if a dispute arises. Please refer to *Resource 1*.

Limited Liability Company

Unlike a sole trader a limited company is a separate legal entity from its directors. This means that the directors are liable only for the amount of money they have invested. However company directors have a number of legal and financial obligations to meet, including dealing with Companies House – the registrar of companies in the UK.

You will be liable to pay Corporation Tax on any profits the company makes, and complete an annual self-assessment return for the income you personally draw down from your company.

The costs of incorporation are not high; you can currently set up a limited company online for £12, but operating as a limited company is slightly more expensive than being a sole trader, mainly due to higher accounting fees.

The main advantage of running your business as a limited company is that you are likely to pay less personal tax than as a sole trader. Limited company profits are subject to UK Corporation Tax, which for the 2018/19 tax year is set at 19%. As a director you may choose to take a small salary and draw most of your income in the form of dividends. By doing this you can minimise the amount of National Insurance Contributions (NICs) you have to pay because limited company dividends are taxed separately, and are not subject to NICs.

A limited company can fund its employees' executive pensions as a legitimate business expense. This can offer a tax advantage over those who are running their business as self-employed.

Also once you register your company with Companies House, your company name is protected by law. No-one else can use the same name as you, or anything deemed too similar.

Limited Liability Partnership

A limited liability partnership (LLP) shares some elements of both the limited company, and the partnership model.

The LLP is a separate legal entity, like a limited company, and is governed by Companies House.

In order to form a LLP, there must be a minimum of two members, which can be individuals or businesses. Therefore if one member chooses the leave the LLP, this may have to be dissolved.

As with an informal partnership it is very important that you enter into a Partnership Agreement. The agreement should cover all aspects of how the business will be run, how any profits will be split and what will happen if a dispute arises. Please refer to *Resource 1.* In a LLP this document is called the Deed of Partnership.

The LLP model is relatively flexible around its operation and membership, and partners are taxed directly via the self-assessment route. However profits cannot be retained in the same way as a company limited by shares. This means all earned profit is effectively distributed with no flexibility to carry profit forward to the next tax year.

Information courtesy of bytestart.co.uk – the small business portal