FULL SPECTRUM
ACCOUNTANCY & TAX

Which Structure for your Business?

Sole trader

This is where an individual carries on a business independently. It is the simplest and most common structure for new or smaller businesses. The individual is effectively the business and must register as self employed with HM Revenue & Customs within 3 months of starting the business.

The sole trader must submit tax returns based on the business's income and expenditure. Only limited detail is reported in the tax return if business turnover is below £67,000 pa. However it is advisable to prepare accounts as they may be useful in the event of a H M Revenue & Customs enquiry. The individual pays income tax on the profits at either 20% or40%. The rules for deduction of expenses for a sole trader are more lenient than those for employees. The profits of the business are the taxable income of the sole trader. Any "wages" taken by the sole trader are drawings and have no tax consequence. In addition to income tax sole traders pay Class 2 National Insurance contributions at a flat weekly rate of £2.40 (2009/10 & 2010/11) and Class 4 contributions at 8% of profits between £5,715 and £43.875 (2009/10 & 2010/11) and 1% on any excess over £43.875.

This is the cheapest entity to run with regards to professional fees for completing tax returns and accounts.

Partnership

This is not a separate legal body but a number of persons carrying on business together. The individual partners are treated very much like a sole trader except a separate partnership tax return is needed in addition to the individual tax returns. This means the individual partners must still register as self employed with HM Revenue & Customs within 3 months of joining the business. Registration for VAT will be based on the turnover of the partnership and not that of each partner.

Accounts may be required and are recommended. A H M Revenue & Customs enquiry into the partnership will include all partners. Partners pay Class 2 and 4 National Insurance contributions on their share of profits in the same way as if they were self employed.

The general law for partnerships is set out in the Partnership Act 1890 and gives the default position where there is no agreement between the partners as to the terms on which they carry on their business. A formal agreement is not necessary, but is recommended. The existence of a partnership can be inferred from factors such as partnership stationery and partnership bank accounts

The business relationships between the partners needs to be governed to provide rules about drawings from the partnership, it's dissolution, the retirement or death of a partner, a partner's individual authority to incur a liability on behalf of the partnership and for the resolution of disputes.

All partners are equally liable for any debts of the partnership, which can be claimed from their personal wealth, not just the partnership assets. If one partner cannot pay then the debt may be enforced against all or any of the others.

Salaries paid to the partners and interest paid on capital is included in the overall profit for tax purposes which is used to calculate the individual partner's share of profits as these are just a form of drawings from the business. Losses of the partnership are shared.

Generally partnerships are slightly more expensive to administer than sole traders. This is due to the extra work involved analysing the separate partner's figures and preparing the partnership tax return.. It offers flexibility where there is more than one business owner and the input and share of profits vary.

Limited Company

This is a separate legal entity and is subject to more regulation than other types of business entity. The business assets belong to the company not to the shareholders or directors. The business debts are also liability of the company and not the individual directors and shareholders. Each company has its legal structure and rules set out in documents called Memorandum and Articles. Annual returns and accounts to Companies House are required.

Corporation tax returns are required and the company will be liable to corporation tax on profits and capital gains. Companies pay tax at between 21% and 28% (2009). The payment of dividends to shareholders are not liable to National Insurance. There is no additional income tax to pay on dividends received by a basic rate taxpayer. The tax advantage of a limited company can currently be maximised in the profit range of £35,000-50,000 saving around £2,000 to £3,500 of tax over those with the same level of self employed profits.

Business profits may be taken as salary, benefits in kind or dividends. Further tax may become payable by the recipient. National Insurance is payable by the company and employees on salaries and benefits. A PAYE scheme will be necessary.

For new companies and those with low asset values lenders may ask the shareholders to act as guarantor for any borrowings. This removes some of the benefit of limited liability..

Companies are normally more expensive than for a sole trade or partnership in terms of professional fees due to the regulatory requirements.

Limited Liability partnership (LLP)

This is a business structure which gives limited liability to partnerships. It is a separate legal entity subject to regulation under Company Law. This means accounts and an annual return have to be prepared and submitted to Companies House. The requirements are not dissimilar to those for a company.

An LLP must be registered and have a minimum of two members. A member's liability to debts of the business are restricted to their capital contribution to the partnership. Generally for tax purposes an LLP is treated as a normal partnership.

This is potentially the most expensive structure for professional fees because it has the profit sharing complexities of a partnership combined with the legal requirements of a company. However, in return it gives the legal protection of a company and the flexibility of a partnership.

It should be noted that where fraud or negligence is involved the individuals may become personally liable for debts even where a limited liability structure is in place.

Joint Venture

This is an association between individuals for a business purpose. It usually arises between individuals who carry on their own trades but agree to cooperate on a single project. If profits and losses are shared then there is a risk that HM Revenue & Customs will consider it a partnership especially if the business is distinct from their existing business.

Joint ventures can be companies or treated as self employment earnings.

Please contact us now if you need any advice or assistance in respect of this fact sheet, or if you would like us to deal with your tax affairs on your behalf.

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