

Choosing a business medium for your start-up

Surviving as a start-up is very often reliant upon setting up a solid business structure at the outset, says ACCA certified accountant Anita Brook of Accounts Assist



When it comes to setting up a company, there are no hard and fast rules about which type of business fits with which trading entity, but it is important that you understand each structure in order to make the right choice for your business.

Sole trader

Acting as a Sole Trader involves one person who must register with HMRC in order to pay income tax and Nation Insurance Contributions.

Sole Traders avoid the paperwork and cost associated with registering with Companies House and are not answerable to partners or shareholders, which some argue makes it easier to make quick decisions and stay competitive. However, they are personally liable for any business debts incurred as well as any legal action taken as a result of their actions in the course of their business.

While National Insurance Contributions are typically lower than they would be on a PAYE scheme, Sole Traders are liable to pay income tax on any salary paid and fixed Class 2 National Insurance plus Class 4 National Insurance on all profits, which can be more costly than paying corporation tax on profits within a Limited company. Further, as the business does not exist as a separate entity, it is difficult to sell on, and difficult to win investors.

Partnership

A Partnership is made up of between two and twenty people, where all partners are 'jointly and severally' liable, meaning that the liability is shared equally between partners. Again, each partner is liable to pay income tax Class 2 and Class 4 National Insurance on their share of the profits.

Partnerships don't have to register with Companies House, so there is less paperwork and accountancy costs than a Limited company. They are considered suitable for individuals who need to retain a degree of independence in the professional capacity, such as accountants and solicitors.

There is no legal requirement for partners to draw up a formal agreement as Partnerships are automatically governed by the Partnership Act 1890. However, it is advisable to draw up a

Partnership deed to avoid default requirements such as the obligation to wind up a Partnership if a partner leaves the business.

Aside from risks associated with debt and legal action and the non-preferential treatment by suppliers and banks, as with Sole Traders, another weakness of the Partnership structure is the problems that can arise if a partner wishes to leave and take their assets. Again, however, a formal agreement can help protect against this.

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Limited Liability Partnership

The Limited Liability Partnership (LLP) is seen by some as offering the 'best of both worlds' as it gives the flexibility, in organisational terms, of a Partnership, but removes liability from the individual by creating a company which acts as a legal entities that is separate the partners within it. As such, the company can own property, enter into contracts and indeed accept liability for debts and legal action, with the individual partners' liability reduced to personal investments, plus any finance raised using personal guarantees

Creating an LLP involves registration with Companies House and a commitment to publicly file annual returns, which means more paperwork and higher accountancy fees than the above structures. However, this also allows the business to 'claim' its name, which can protect the brand to an extent.

LLPs are treated as Partnerships for tax purposes and are governed by LLP Act 2000 and LLP Regulations 2001 which makes it more flexible in terms of legal requirements than a Limited company, however it is advisable to have a written agreement in place between partners to avoid costly misunderstandings.

Limited

Limited companies require directors to operate within defined roles, with ownership defined by shareholdings. In this way, there is less danger of confusion or disputes than with an LLP or Partnership. As with LLPs, Limited companies are required to register with Companies House and exist as separate entities from shareholders, making the reduction in liability one of the most attractive features of this trading entity, despite the added paperwork and accountancy costs.

The Limited structure is the only structure option which allows owners to raise capital by selling shares. In addition, Limited companies are generally the most likely of the four structures to secure investment from banks as the level of regulation imposed on the entity means it is considered a safer investment.

Creating a Limited company can also facilitate tax savings. For example, a Director could draw a

salary below the threshold for 40% income tax, pay just 21% corporation tax on the profits (providing the profits do not exceed £300,000) and then draw the profits as a dividend.

It is clear then, that each structure presents its own set of pros and cons, so your decision should be made after careful consideration of each element of your business, including the number of people involved, the level of profit you are likely to make, and who you intend to trade with. Of course, if you are in any doubt, it is wise to seek third-party advice before making a decision.

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