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SPOTLIGHT ON:

Choosing the right business structure

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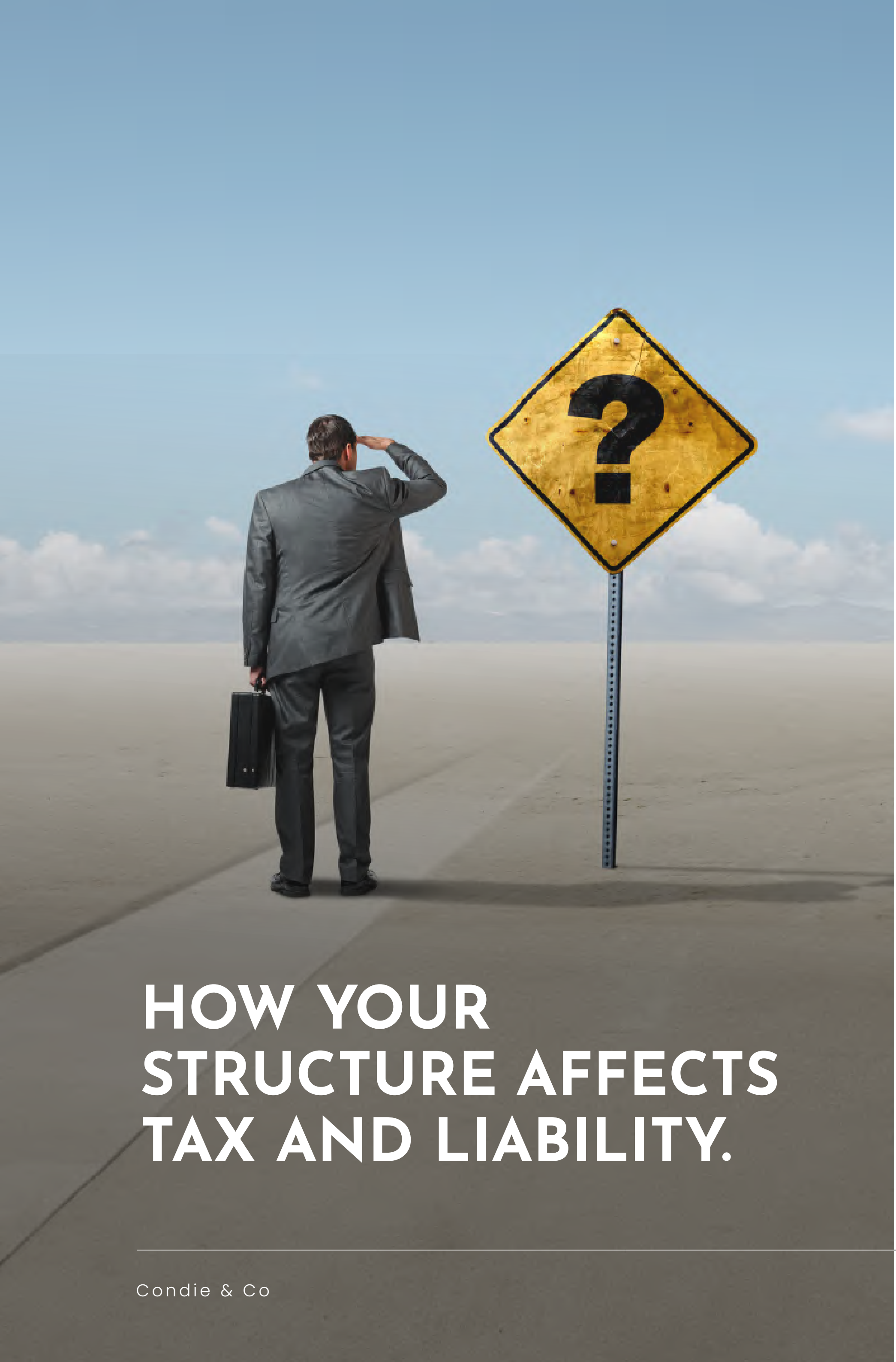

HOW YOUR STRUCTURE AFFECTS TAX AND LIABILITY.

Choosing the appropriate structure for your business is one of the first and most important decisions you will make. It affects everything from your tax obligations to the level of personal liability you will face, and even how you can raise funds. If you are thinking of starting a business, or restructuring an existing business, it is worth taking a closer look at the options available to ensure you make the best choice for your business.

KEY CONSIDERATIONS WHEN CHOOSING YOUR STRUCTURE

When choosing the right structure for your business, there are several key factors to consider.

1. **Tax implications**: Different structures come with different tax obligations. Sole traders and partnerships are taxed on their income, while limited companies pay corporation tax and may benefit from lower personal tax rates on dividends.
2. **Personal liability**: One of the main advantages of a limited company or limited liability partnership (LLP) is the protection of personal assets. If personal financial exposure is a concern, these structures may be more appropriate.
3. **Compliance and administration**: Limited companies and LLPs require more administrative work, including filing annual accounts and tax returns, which in turn results in additional costs. Sole traders and partnerships, on the other hand, have fewer regulatory requirements.
4. **Investment and growth**: Some structures make it easier to raise capital or attract investors. For example, limited companies can issue shares, whereas sole traders and partnerships may struggle to attract outside investment.
5. **Tax flexibility**: One advantage of a limited company is the ability to retain profits within the business without needing to withdraw them as dividends. This can allow you to defer tax liabilities, whereas sole traders and partners are taxed on the entirety of their profits in the year they are earned. This flexibility can be useful for managing cashflow and planning for future growth.
6. **Perception and credibility**: Operating as a limited company can enhance your business's credibility. Many clients and potential partners view a limited company as more official and established compared to a sole trader, which can help build trust and attract larger contracts or partnerships.
7. **Long-term goals**: Consider the future direction of your business. While starting as a sole trader or partnership may be simpler, switching to a limited company down the line could bring added tax benefits and protections.

UNDERSTANDING YOUR OPTIONS

There are several business structures available in the UK, each with its own set of advantages and drawbacks. These include sole traders, partnerships, limited liability partnerships (LLPs) limited companies, and community-interest companies (CICs). The choice you make should be based on your business's size, industry, long-term goals and the personal preferences of those involved. Let's examine each structure more closely.

SOLE TRADER

The simplest and most common business structure in the UK is the sole trader. As a sole trader, you are the sole owner and responsible for all aspects of the business, including its debts and liabilities. While this offers great flexibility, it also means that your personal assets are at risk if the business faces financial difficulties.

From a tax perspective, as a sole trader, you will pay income tax on your business profits through the self-assessment system. National Insurance contributions (NICs) are also applicable, though for the 2024/25 tax year, Class 2 NICs have been scrapped and are now only payable on a voluntary basis. You will still pay Class 4 NICs on profits between £12,570 and £50,270 at 6%, with a 2% rate on profits above £50,270.

Many individuals choose this route because it is easy to set up and manage. However, as the business grows, it may be worth considering whether a more structured approach, such as forming a limited company, could offer better tax efficiencies and protection.

PARTNERSHIP

A partnership is similar to being a sole trader but involves two or more people sharing responsibility for the business. Each partner shares the profits, as well as the risks, liabilities and losses. Like sole traders, partners are personally liable for any debts the business cannot cover.

From a tax perspective, partnerships also fall under the self-assessment system, with each partner paying income tax and NICs on their share of the profits. For the 2024/25 tax year, the same NIC thresholds and rates apply as for sole traders. There are likely to be slightly more administrative burdens when compared to acting as a sole trader as you'll want to draft a partnership agreement, as well as have partnership accounts prepared each year.

One of the main advantages of a partnership is the pooling of resources and expertise. However, the lack of personal liability protection can make it a risky option for those involved, especially in sectors with higher levels of financial exposure.

LIMITED LIABILITY PARTNERSHIP (LLP)

For those who want the benefits of a partnership but with added protection, a limited liability partnership (LLP) may be a better fit. In an LLP, each partner's liability is limited to the amount they have invested in the business. This can be particularly useful for professional services businesses, such as law firms and accountancy practices.

LLPs are taxed similarly to partnerships, with each partner paying income tax and NICs through self assessment on their share of the profits. However, as LLPs are legally separate entities, the business itself must comply with certain administrative requirements, such as filing annual accounts and a confirmation statement with Companies House.

An LLP provides a flexible structure with the added benefit of limiting personal financial exposure, but the increased administrative burden may not be suitable for every business.

LIMITED COMPANY

A limited company is a separate legal entity from its owners (shareholders) and directors. This means that, unlike sole traders and partners, the personal assets of the shareholders and directors are protected if the company faces financial difficulties. However, the increased protection comes with greater responsibility in terms of compliance and administration.

Limited companies in the UK pay corporation tax on their profits. For the 2024/25 tax year, the main rate of corporation tax is 25% for companies with profits over £250,000. Companies with profits between £50,000 and £250,000 will pay a tapered rate between 19% and 25%, while those with profits under £50,000 will continue to pay 19%.

Shareholders may also be liable to pay tax on dividends. The dividend allowance for the 2024/25 tax year is £500, with dividends above this threshold taxed at rates of 8.75%, 33.75% and 39.35% depending on your income tax band.

For many businesses, the tax efficiencies offered by a limited company structure outweigh the increased administrative responsibilities. However, it's important to understand the implications for cashflow and the additional legal requirements that come with running a company.

COMMUNITY-INTEREST COMPANY (CIC)

A community-interest company (CIC) is a type of limited company designed specifically for social enterprises. CICs must work for the benefit of the community and are subject to additional regulations that ensure their profits are used to achieve their social objectives.

CICs can either be limited by shares or by guarantee, and they must submit an annual community interest report to demonstrate how they are benefiting the community. While CICs do not receive any special tax treatment, they may be eligible for certain grants or other forms of funding that are not available to other types of businesses.

For those looking to balance running a business with making a positive impact, a CIC may be the most suitable option. However, the additional regulatory requirements should be carefully considered before proceeding.

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LEGAL AND REGULATORY REQUIREMENTS

When choosing a business structure, it's important to understand the legal and regulatory obligations associated with each option. These requirements vary depending on the structure you select and may involve everything from initial registration to ongoing compliance.

Sole traders are the simplest structure in terms of legal obligations. If you operate as a sole trader, you must register with HMRC for self assessment and ensure you submit your tax return each year. There's no requirement to file annual accounts or register with Companies House. However, sole traders are still required to keep accurate records of their income and expenses.

Partnerships share similar obligations to sole traders but with the added responsibility of registering the partnership with HMRC. Each partner is responsible for paying tax on their share of the profits, and accurate records must be kept for both individual partners and the partnership as a whole.

For **limited liability partnerships (LLPs)**, the regulatory requirements increase. In addition to each partner submitting their own self assessment tax return, the LLP itself must file a partnership tax return (SA800) with HMRC, detailing the business's income and how it is divided among the partners. LLPs must also register with Companies House, submit annual accounts, and file a confirmation statement each year.

Limited companies face the most stringent legal requirements. They must register with Companies House, appoint directors, file annual accounts and submit a confirmation statement.

Additionally, limited companies must register for corporation tax with HMRC and file a corporation tax return each year. Directors have a legal responsibility to act in the best interests of the company and comply with company law, including maintaining accurate statutory records and minutes of key decisions.

Failing to meet these legal and regulatory requirements can result in penalties, fines and even the risk of being struck off the Companies House register. Therefore, it's essential to stay on top of your obligations, regardless of the structure you choose.

COME TO US FOR FURTHER ADVICE

The decision about which business structure to choose is not one to take lightly. Each structure comes with its own set of benefits and responsibilities, and the right choice for you will depend on your specific circumstances, goals and plans for the future.

We are here to help you make the best decision for your business. Whether you're just starting out or considering restructuring an existing business, we can offer tailored advice based on your needs.

Contact us today to discuss how we can support your business in making the right choice for the future.

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