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## Sole trader, partnership or limited company?

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Once you have decided that you would like to set up a business and what that business is going to do then you will need to decide how it will be structured.

The structure will depend upon many factors and you should consider:

- how the business will be funded
- how and by whom the business will be managed
- how profits/losses are to be shared and taken/repaid
- the keeping of accounts
- how tax is to be paid
- the desired extent of personal liability
- expectations of customers and suppliers
- plans for the future exit of individuals from the business
- your expansion strategy

There are basically four business structures for smaller businesses: sole traders, partnerships, limited liability companies and limited liability partnerships. Whilst an overview of each is given below there are no hard and fast rules governing which structure will best suit any particular business. We would always suggest you seek the advice of a solicitor and an accountant at an early stage. This could save you considerable money in the future by avoiding the upheaval of a re-structure.

### Sole Trader

This is the simplest form of business. As the name suggests it is one person trading either under their own name or a business name. To be clear, that is one person in control. You can employ any number of people in the business.

As a sole trader you would have complete control over the business and all the profits (after tax) will be yours.

On the downside, you will personally be accountable for any debts and liabilities that the business incurs down to your last penny. This includes any bank or other lender loans that might be raised in order to start the business and keep it afloat in the early months before

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cash flow begins to kick in. There is no safety net: ultimately all your personal assets, including your home, could be lost if your business fails.

If you run a business where there is risk of personal injury to third parties (e.g. catering or bouncy castle hire) then it is vital that you are insured against these risks. This is true whichever business structure you decide upon but is particularly important when you are personally liable.

Compared to the other forms of business listed below the administration of a sole trader is fairly simple. You will need to keep accurate records of income and expenditure and file an annual self-assessment tax return.

## **Partnership**

Effectively a partnership is like two or more sole traders joining forces to set up a business together.

Partners, like sole traders, will be personally liable for the debts and liabilities of the partnership. In this case the liability is joint and several (other than liability for tax). This means a creditor could pursue all of the partners to recover a debt, or select an individual partner (probably the one with most personal wealth). The individual partner would then have to seek recompense from the other partners under the terms of the partnership agreement (or default statutory rules if one doesn't exist).

As a consequence you should only go into partnership with people you trust. Of course you will also have to be able to work with them without spending your whole time in dispute. And they should add something to the venture, probably beyond mere money. Often you will be better off paying interest to a lender than carrying a non productive partner.

On the positive side the partners will share all the profits in accordance with the partnership agreement (or statutory rules) and there is some spread of risk through the partners.

Compared to a sole trader, an extra layer of administration is added because partnership accounts will have to be drafted and approved to calculate and divide the profit (loss) between the partners, in accordance with the partnership agreement. Each partner must then submit their own personal self-assessment tax return.

If you wish to set up a business as a partnership you should consult a solicitor to draft a partnership agreement. Without one, the default rules set out in the Partnership Act 1890 will apply. As you can probably guess, these rules don't always align themselves well with modern business practices and can prove to be inadequate and inflexible. Sadly, all too often prospective partners allow enthusiasm for a business venture to propel them into active partnership without getting the safety net of a partnership agreement in place first. Whilst this may save pennies in the short term it could cost pounds in the long term.

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## **Limited liability company**

The main advantage of the limited liability company (company) to the majority of business people is that your personal liability is limited to the share capital you hold in the company. Therefore your personal wealth and home are not at risk. This is because the company is a separate legal entity and it is liable for its own debts.

Unfortunately, before a company has built its capital base and reputation, it is likely that you will have to act as a personal financial guarantor in any loan agreement the company needs to enter into or on any business lease etc. Therefore, particularly in the early days of a business, the limited liability aspect can be largely illusory.

Whilst the costs of setting up a company are more or less the same as those of a partnership the running costs can be more. For example, there are a number of mandatory statutory provisions that require the company to make certain decisions in certain ways and to file certain company decisions and the company's accounts at Companies House.

In terms of return on your investment of time and money, the company will be taxed at corporate rates on its profits. The net profit will then either be retained in full or in part and/or paid as a dividend to the share holders in proportion to the number and type of shares held or as directors' remuneration.

## **Limited liability partnership (LLP)**

An LLP has a distinct legal entity much like a company and therefore offers the partners the safety net of limited liability.

The more rigid structure imposed on companies does not apply to LLPs so there is more flexibility in choosing a decision making process. However, the adoption of LLPs is relatively recent and it is yet to be seen whether any unforeseen problems with this may come to the surface.

The LLP is a cross between the partnership and the company. That doesn't mean that it's purely a mix of all the best bits though. It comes with similar filing and disclosure requirements to those of a company.

The members of an LLP are taxed individually, much like partners in a partnership.

If you would like further information or advice please contact Steven, Tom or Philip who will be happy to assist you or visit [www.gardandco.com](http://www.gardandco.com).

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