

Choosing a business structure

The main business structures are:

- sole trader
- partnership
- incorporation
- limited liability partnerships

SOLE TRADER

Sole trading is when an individual is the only owner of the business and has complete control over the way it is run. The law makes no distinction between the business and a sole trader and they are treated as one and the same.

A sole trading business tends to be small in size, with a low turnover and few employees. But there are an estimated 3.7 million active businesses in the UK and over 2.3 million of these are size class zero businesses - that is businesses without employees.

Advantages

- bookkeeping is generally fairly straightforward and simple accounts can be prepared which do not have to be audited
- there is little red tape and setting up is simple

Disadvantages

- personal liability for all business debts
- the business usually ceases on the owner's retirement or death
- entitled to few social security benefits
- options for raising finance are more limited
- can be hard not having a business partner to share all responsibilities with

PARTNERSHIP

A partnership is an arrangement whereby two or more people form a business unit in which each person is a partner. A partnership agreement, drawn up with legal advice, is essential both to protect each partner, and also to force partners to think through issues such as roles, responsibilities, exit routes, etc. This agreement will fix all financial details such as each partners remuneration, the amount of capital they have to put into the partnership and each partners responsibilities and voting rights.

Advantages

- new partners can be taken on to raise finance or to provide specialisms
- partners can provide mutual support and improved decision-making through discussion and debate
- partners will bring to the business different skills, knowledge and experience

Disadvantages

- personal liability for all business debts including those incurred by the other partners
- the requirement to consult with your partners in making decisions and consequently the loss of autonomy and potential for disagreement
- decision-making may take longer as consensus must be reached
- different partners may have different aims and targets for the business
- conflict may arise between the partners on personal and/or business grounds.

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INCORPORATION

Incorporation is the process of forming a corporate body - usually in the form of a limited company. The term limited refers to limited liability. Whereas sole traders and partners can be held personally liable for all business debts, a limited company is a separate legal entity to the owners and can own property, incur debts, sue and be sued in its own right. Any business dealings are made on behalf of the company so the owners are normally liable only for the amount invested.

There must be at least one director to manage the business and a company secretary to make sure all the rules are followed and official records maintained.

There are several methods of setting up a company:

- dealing directly with Companies House
- enlisting the services of an accountant, company formation service or online registration company to provide an 'off the shelf' or readymade company.

Advantages

- financial liability is limited to only what has been personally invested
- shares in a company are easier to transfer than a partner's interest in a business
- a company still exists upon the retirement or death of its owners
- a limited company has more credibility making it easier to raise finance
- a company is subject to corporation tax rather than income tax which is usually advantageous for small businesses
- a company can pay dividends which can be advantageous to the shareholders in some circumstances.

Disadvantages

- annual accounts are more complicated and certain details need to be filed with the Registrar of Companies which makes that information available to the general public
- more much administration and paperwork
- a statutory audit is compulsory if turnover exceeds £1 million
- directors are treated as employees and so are subject to PAYE/NIC on their earnings
- it can be more difficult and expensive to wind up a company than it would be for a sole trader or partnership
- shareholders and directors may have to personally guarantee contracts entered into with lenders or suppliers so personal liability can still arise

For further information, read ACCA's booklet on Incorporation.

LIMITED LIABILITY PARTNERSHIPS (LLPS)

The LLP resembles the limited company in two key respects - it is a body corporate with separate legal personality, and the liability of its 'members' is limited. In so far as its status and external responsibilities are concerned, the LLP is very similar to the limited company. In terms of its internal affairs, however, it is more similar to the traditional partnership. An LLP can be formed by at least two natural or legal persons and it is advisable to have a suitable members' agreement drawn up. A qualified accountant can help you with these formalities.

Advantages

- it is a body corporate with its own legal identity and capacity
- members can limit their personal liability for business debts
- it has the organisational flexibility of a partnership
- the members' agreement is confidential.

Disadvantages

- annual accounts must be prepared and filed
- there are other filing requirements with strict time limits for compliance
- withdrawals may be clawed back if the LLP is declared insolvent within the next two years
- each member is subject to income tax on his/her own income from the firm as if they were self-employed.

For further information, read ACCA's booklet on Limited Liability Partnerships.