

Business Trading Entities - What Should You Be?

Starting a business can be a complex process and the decision about what trading information you choose should not be treated lightly. The following information is not an exhaustive explanation of each option, but should serve to answer many questions.

Sole trader

Who is it suitable for?

Individuals wanting to be self-employed or as a first step for someone who has bigger plans but wants to 'prove' his business acumen first.

The legal entity

A sole trader simply needs to register with HMRC as being self-employed, there is no requirement to register the business at Companies House. There are no exclusions on the trading style, eg Peter White trading as White's Burger Bar (however you should make sure that your chosen trading style is not already in use and protected, for instance Peter White cannot trade as MacDonalds).

Liabilities

You are responsible for every debt incurred and as such your assets (perhaps your home) can be seized/sold to pay creditors.

Advantages

It's an easy, cheap to initiate and simple solution to running a business. Because you are the owner, your word is final on all matters. You are entitled to all of the profits.

Disadvantages

Liability can be a disadvantage. Banks may be reluctant to lend money or may only lend where the individual has personal wealth. There can be an image problem if you have plans to take your business to a higher level. As a sole trader, you may well be doing everything yourself.

Partnership

Who is it suitable for?

Two or more persons who want to start a business together. Usually the partnership will be made between family members or friends and although not a legal requirement, it is worthwhile having a 'Deed of Partnership' drawn up that establishes rules and responsibilities, arrangements regarding income, etc.

The legal entity

A partnership is 'what is says on the tin'! Even if you don't have a formal written agreement the fact is that two or more people (or entities) carrying on some form of trade or business together with a view to profit will form a partnership, with all that it entails, whether they like it or not.

Liabilities

The partners are responsible for every debt incurred and as such their assets (perhaps a home), can be seized/sold to pay creditors. In practice, creditors may choose to pursue one of the partners if that partner has greater personal wealth. Unless a ruling is established via a Deed of Partnership, one partner can commit the partnership to a contract without referring to the other partner.

Advantages

It's an easy, cheap to initiate and simple solution to running a business and there is less paperwork than for a limited company. Because the partners are the owners, their word is final on all matters and how the business is run is their decision. The partners may withdraw money at any time and are entitled to all of the profits; profits are classed as income and attract a lower rate of national insurance.

Disadvantages

Liability can be a disadvantage. Banks may be reluctant to lend money or may only lend where one of the partners has personal wealth. A partnership is not a legal entity in its own right. Although partnerships are plentiful, there may still be a problem of image if the business embarks upon a path of continual expansion.

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Limited Liability Partnership (LLP)

Who is it suitable for?

Two or more persons who seek to operate a business as a partnership but want greater protection in the form of limited liability.

The legal entity

Every LLP must register with Companies House and will be issued a Certificate of Incorporation. An unlimited number of persons can be admitted to an LLP and the persons within in LLP are called Members. The LLP is a legal entity in its own right and as such can enter into contracts in place of the Members. This means, for instance, that the LLP can own/lease land, can sue or be sued and can grant a floating charge or debenture to bankers.

Liabilities

Whilst the LLP is liable for the full extent of its commitments, the liability of Members is limited. Unless personal guarantees of the Members are given, they are only at risk of losing the amount that they initially invested. Banks and other organisations may ask for personal guarantees and it is up to the individual Members to decide if they wish to accede. It is possible for one or more Members to refuse and other Members to agree. The LLP itself can be the guarantor to lending arrangements of other businesses.

Advantages

An LLP gives the benefits of limited liability but crucially, whilst its members will have similar responsibilities to those of directors, they also have the flexibility to organise the internal structure of the business as a conventional partnership.. This is reflected in the manner with which profits are dealt with because an LLP does not pay corporation tax and the Members are taxed as self-employed persons. Additionally, the admission or departure of members within the LLP is more straightforward than in a partnership.

Disadvantages

LLPs are not yet widespread and consequently their structure is not universally understood which can lead to concerns about status from suppliers.

LLPs must produce audited accounts and file these with Companies House. All of their accounts are therefore open to public inspection. Although the members of an LLP are only liable to lose the capital that they have invested in the LLP, there are some complex rules governing this principle and under exceptional circumstances, claims for economic loss may be made against members deemed to have acted in a negligent manner. Such claims are pursued as a civil action.

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Limited Company

Who is it suitable for?

Individuals who want a business that limits their personal liability, can offer a value beyond their own personal involvement (i.e. it can be sold and continue trading) and can attract investment from other parties that have little input regarding day to day running

The legal entity

After checking that the name you plan to use is available, the company is registered at Companies House. The Registration also includes details of all directors and the company office address. Articles of Association and a Memorandum must be drawn up. The company has to complete an annual return, hold an annual meeting, and will probably have to register for VAT. Because the company is a legal entity in its own right, it can be sold, or buy other companies, it can enter into contracts and can sue or be sued.

Liabilities

The Limited Company is responsible for all of its own debts whereas an individual's shareholding may be at risk, their personal assets are protected should the business fail. Banks and other organisations may ask for personal guarantees of the directors and it is up to the individual director to decide if they wish to accede. The company itself can be the guarantor to lending arrangements of other businesses.

Advantages

Limited liability means that the directors are free to run the business as they see fit and may for instance choose to adopt a high risk strategy in pursuit of rapid expansion or new markets. A limited company is generally taken seriously in its business transactions affording it the opportunity of negotiating favourable trading terms. The directors can

choose to sell the company to outsiders; this is a proven way of attracting funding for expansion. There are various tax avoidance measures for both the company and its directors (although they change regularly). A share of the profits, in the form of dividends, can be paid to the shareholders.

Disadvantages

You have an administrative burden of accounting and financial disclosure. Annual accounts: for smaller companies, full accounts aren't required; a shorter-form report is now acceptable. Annual Return: a document detailing key company facts and personnel, which must be sent to Companies House. The Directors are employed by the company through the PAYE tax system.

Who to contact for assistance

If you require any further information about this or any other commercial matter, please do not hesitate to contact us. We are experienced in assessing the commercial and legal implications of business decisions and this means that we deliver comprehensive and valued results time after time.