



# DRAGONFLY

TAX, ACCOUNTANCY & FINANCIAL MANAGEMENT

## Choosing the right legal structure for you

When starting a new business your decision on how to structure it is an important one. It will have a impact upon;

- which authorities you have to notify that your business exists
- the tax and National Insurance that you pay
- the records and accounts that you have to keep
- your financial liability if the business runs into trouble
- the ways your business can raise money
- the way management decisions are made about the business

### Sole-trader

Operating as a sole-trader is the simplest way to run a business. You do not pay any registration fees, keeping records and accounts is straightforward, you can employ staff and you keep all the profits. However, you are personally liable for any debts that your business runs up, which make this a risky option for businesses that need a lot of investment.

**Management and raising finance:** You make all the decisions on how to manage your business but you'll have to raise money for the business out of your own assets and/or with loans from banks or other lenders with your own assets as security.

**Records and accounts:** You must keep records showing your business income and expenses.

**Tax and National Insurance:** As you are self-employed:

- your profits are taxed as income
- you pay fixed-rate Class 2 National Insurance contributions (NICs) regardless of any profits you make
- you pay Class 4 NICs on any profits
- you need to register for Self Assessment and complete a tax return each year

**Liability:** You are personally responsible for any debts run up by your business. This means your home or other assets may be at risk if your business runs into trouble.

## Partnerships

Partnerships are a very common extension of the sole trader model, and a relatively simple and flexible way for two or more people to own and run a business together. It's a good idea to draw up a written agreement between the partners. There are three types of partnership:

- 'ordinary' partnerships
- limited liability partnerships (LLPs)
- limited partnerships

### 'Ordinary' partnerships

An 'ordinary' partnership has no legal existence distinct from the partners themselves. If one of the partners resigns, dies or goes bankrupt, the partnership must be dissolved, although the business can still continue.

Ordinary partnerships also have to be registered with HMRC for tax purposes. The nominated partner does this by registering the partnership for Self Assessment.

The partners are jointly liable for any amounts owed by the partnership and so are equally responsible for paying off the whole debt. Partners do not enjoy any protection if the business fails. Creditors can claim a partner's personal assets to pay off any debts - even those debts caused by other partners. If a partner leaves the partnership, the remaining partners may be liable for the entire debt of the partnership.

### Limited liability partnerships (LLPs)

LLPs must have at least two designated members - the law places extra responsibilities on them. If for any reason the number of designated members falls to one, every member is deemed to be a designated member.

LLPs must:

- register with Companies House
- send Companies House an annual return
- file accounts with Companies House

When they receive the registration Companies House inform HMRC that the LLP has been set up. HMRC will set up the LLP's tax records so there is no need to register with them.

A partner's liability is limited to the amount of money they have invested in the business. It is also limited to any personal guarantees they have given to raise finance. This means that members have some protection if the business runs into trouble.

### Limited partnerships

A limited partnership is made up of a mixture of ordinary partners and limited partners. Limited partnerships must register with Companies House but don't generally have to make an annual return or file accounts. When they receive the registration Companies House inform HMRC that the limited partnership has been set up. HMRC will set up the partnership's tax records so there is no need to register with them.

Ordinary partners are jointly liable for any debts owed by the partnership and so are equally responsible for paying off the whole debt. A limited partner's liability is limited to the amount of money they have invested in the business. It's also limited to any personal guarantees they have given to raise finance.

## Limited Company

Limited companies exist in their own right. This means the company's finances are separate from the personal finances of their owners.

**Management and raising finance:** The director (or the board of directors) makes the management decisions. Directors may also be shareholders. Directors must notify Companies House of changes in the structure and management of the business. Finance comes from shareholders, loans and retained profits. Any profits are usually distributed to shareholders in the form of dividends, apart from profits retained in the business as working capital.

**Records and accounts:** A private company:

- Must be registered (incorporated) at Companies House.
- Does not have to appoint a company secretary but if one is appointed, this must be notified to Companies House.
- Must file its accounts annually with Companies House. The accounts must be audited unless the company is exempt.
- Must send an annual return to Companies House.

**Tax and National Insurance:** If the company is active, it must tell HM Revenue & Customs (HMRC) that it exists and is liable to Corporation Tax. It must then pay any Corporation Tax that's due and submit an annual Company Tax Return to HMRC.

Company directors are an office holder of the company and therefore regarded as an employed earner for the purposes of paying National Insurance contributions (NICs). As such, company directors must pay both income tax and Class 1 NICs on their director's earnings.

Company directors must complete a Self Assessment tax return each year. You will need to give details of the income from your directorship on the employment pages. If you do not usually fill in a tax return you must register for Self Assessment.

**Liability:** A company may be limited by shares or limited by guarantee:

- a company is limited by shares if members' liability is limited to the amount, if any, unpaid on the shares held by them
- a company is limited by guarantee if members' liability is limited to an amount the members agree to contribute to the company in the event of its being wound up

For a company limited by shares, shareholders are not responsible for the company's debts unless they have given guarantees - eg a bank loan. However, they may lose the money they have invested in the company if it fails.

Shareholders may be individuals or other companies. However, shares cannot be offered to the general public.

## Public Limited Company (PLC)

Public limited companies' (PLCs) finances are separate from the personal finances of their members. PLCs must:

- Have at least two shareholders.
- Have issued shares to the public to a value of at least £50,000 or the prescribed equivalent in euros before it can trade.
- Be registered (incorporated) at Companies House
- Have at least two directors - at least one must be an individual. Each director who is an individual must be at least 16 years of age.

- Have a qualified company secretary.

**Management and raising finance:** PLCs are the only type of business that can raise money by selling shares to the general public, either individuals or other companies, although they may not necessarily be traded on a stock exchange. Finance can also be raised through loans and retained profits.

A board of directors usually makes the management decisions.

**Records and accounts:** PLCs must;

- send an annual return to Companies House
- file accounts with Companies House once a year (the accounts must be audited unless the company is exempt)
- must notify Companies House of changes in the structure and management of the business.

**Tax and National Insurance:** If the company is active, it must tell HM Revenue & Customs (HMRC) that it exists and is liable to Corporation Tax. It must then pay any Corporation Tax that's due and submit an annual Company Tax Return to HMRC.

Company directors are an office holder of the company and therefore regarded as an employed earner for the purposes of paying National Insurance contributions (NICs). As such, company directors must pay both income tax and Class 1 NICs on their director's earnings.

Company directors must complete a Self Assessment tax return each year. You will need to give details of the income from your directorship on the employment pages. If you do not usually fill in a tax return you must register for Self Assessment.

**Liability:** The liability of each member is limited to the amount unpaid on their shares. Members are not responsible for the company's debts unless they have given personal guarantees - eg when taking out a bank loan.

### Community Interest Company (CIC)

A CIC is a type of limited company designed for people who want to run a business for the benefit of the community. They are not purely for the benefit of the company's members and shareholders. A company cannot become a CIC if it is a charity or intends to be a political party, a political campaigning organisation, or a subsidiary of either. However, a charity can convert to a CIC with the consent of the Charity Commission.

**Management and raising finance:** A CIC may be a public or private company limited by shares or guarantee and so is managed and can raise finance as a Limited Company or Public Limited Company.

**Records and accounts:** If you intend to set up a CIC, you must register it with Companies House and must;

- send an annual return to Companies House
- file accounts with Companies House once a year (the accounts must be audited unless the company is exempt)
- must notify Companies House of changes in the structure and management of the business.

However, it's the CIC Regulator that decides whether or not your company is eligible to become a CIC. You must pass a 'community interest test' and 'asset lock'. These ensure that the:

- CIC is established for community purposes
- assets and profits are dedicated to these purposes

**Tax and National Insurance:** CICs do not enjoy any special tax status as such and are liable for Corporation Tax in much the same way as a Limited Company or Public Limited Company.

If the company is active, it must tell HM Revenue & Customs (HMRC) that it exists and is liable to Corporation Tax. It must then pay any Corporation Tax that's due and submit an annual Company Tax Return to HMRC.

In the case of a CIC existing as a company limited by shares, a 'dividend cap' must be put in place. The purpose of this is to ensure that a balance is achieved between providing an attractive investment opportunity (often essential in stimulating and maintaining the financial backing required to run the CIC) and making sure that the majority of the profits made are applied for the community benefit

**Liability:** As with normal companies a CIC benefits from Limited Liability. The liability of each member is limited to the amount unpaid on their shares. Members are not responsible for the company's debts unless they have given personal guarantees - eg when taking out a bank loan.

**Please contact me if you would like further help or advice.**

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