

Partnership, LLP or Company?

A dilemma that often faces those who run their own business is what structure they should adopt and what the benefits and drawbacks are. Whether you are starting your own business or have been operating for a number of years it is worthwhile considering whether the way that you operate is the most efficient from both a tax point of view and from a liability point of view. The structure that you choose within which to run your business will define your legal responsibilities such as the paperwork you are required to complete, the taxes you will have to pay and your personal responsibilities in the event that the business makes a loss.

Running a business can be exciting and challenging and when starting a new business the desire to work hard and build a good reputation can lead to issues such as personal liability and how best to get your money out of the business to be put to one side. Just as many people put off making a Will, some people focus all of their time and attention on building up a business without considering whether they could operate in a different way that would make life easier for them.

There are three types of business – a sole trader, a business partnership and a limited company. The simplest form of business is to operate as a sole trader. If you start to work for yourself then you are classed as being self-employed and will be required to complete a self-assessment tax return each year and pay income tax on the profits that your business makes. All profit that is generated is yours to keep and if you employ anyone else in the business then you remain liable and responsible for their actions and omissions. Basically, if you get things wrong or one of your employees gets something wrong then you are personally liable and your personal assets are at stake. Whilst many people enjoy the freedom of being their own boss and not having to worry about filing annual returns with Companies House or ensuring compliance with company legislation the risks of personal liability make many people consider an alternative structure.

Many businesses operate as a business partnership where two or more people pool their knowledge, experience and assets and share a responsibility for the business. Whilst it is the case that there is safety in numbers there is also the legal liability of joint and several liability which means that the debts of the partnership may all fall upon one person if the other Partner does not have the means with which to settle their liabilities. In a straight forward partnership you are taxed as an individual on the Partnership profits that you receive and remain personally liable. It has become

increasingly popular for a number of businesses, including professional such as Accountants, Surveyors and Solicitors to transfer their business in to a Limited Liability Partnership (LLP). An LLP provides the protection of limited liability so that the Partners of members of the LLP are not personally liable for the debts that the business can't pay and their liability is limited to the amount of money they invest in the business. The individuals are still taxed based on income tax in respect of their share of profits and the Partners will hold capital in the business with the accounts prepared each year being on a similar basis to those prepared for a General Partnership.

A limited company is a separate legal entity and offers protection to the Shareholders/Members of the company. The limited company is responsible in its own right for everything it does and enters in to contracts in its own name with staff being employed by the company rather than the individual Shareholder. The owners of the business each own a share of the company and the Shareholders are able to determine how the share of the profits of the company are distributed via dividends. The day to day management of the company is carried out by the Directors of the business and these Directors have legal responsibilities that are set out in the Companies Act 2006. The company Directors are not personally liable for the debts of the business unless they breach certain rules and laws in respect of their conduct. It is necessary for a company to file an annual return each year setting out who the Directors and Shareholders are and the company is required to file annual accounts with Companies House which are a public record.

The Company is required to complete a Company tax return and the Shareholders would be required to complete a self-assessment tax return in relation to any dividend or income that they receive or if they are employed by the Company they will also be subject to income tax and national insurance payments through the PAYE system.

Many people seek the protection of a limited company in order to protect their own personal assets, however, it must be borne in mind that Banks and other parties who deal with new start companies often require personal guarantees from the main Shareholders or Directors.

It is important to obtain advice from a Solicitor and an Accountant in relation to the most appropriate business structure for you as the needs of each individual business are different. It is important for any partnership, LLP or limited company to have in place a written form of agreement (whether a Partnership Agreement, Members' Agreement or Shareholders' Agreement) that sets out each party's roles and responsibilities and looks to cover what would happen if someone wished to leave the business, someone dies or someone is ill. We often describe such an agreement as an "umbrella" as you only bring it out when it rains, however, an investment in this sort of an agreement at the outset of a business venture can save thousands of pounds if the parties fall out in the future.

The choice of business structure is not one that should be taken lightly and although it is possible to switch between business structures, there may be tax and other implications to bear in mind when doing so.

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