



## **Business Structure**

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## Introduction

This document researches different types of business structures and explains what sort of business structure is best for our company. It is important to select the correct type of business because it affects the amount of tax the business pays, the amount of paperwork you have to do and rather importantly, personal financial liability.

After some research I found the most common legal structures for start up companies are **sole trader**, **partnership** and **private limited companies**.

## Types of companies

### Sole Trader/Proprietorship

This is the simplest type of company as it is for companies with a single owner who operates the business. This is good for people who want to work on their own and is easy and relatively cheap to establish. The paperwork is minimal and tax aspects are appealing because business expenses and income are included on your personal tax return.

However, the main disadvantage of this company is that the owner is responsible all liabilities of the business, including debt and losses.

### Partnership

A partnership is where 2 or more people start a business for profit. The Uniform Partnership Act states:

"The association of two or more persons to carry on as co-owners of a business for profit forms a partnership, whether or not the persons intend to form a partnership."

One of the major advantages of a partnership is the tax aspects. A partnership does not pay tax on its income but "passes through" any profits or losses to the individual partners.

Interestingly, a partnership can be formed without any formal declarations, which often means partnerships are established accidentally through oral agreements. However, all partnerships should be formed with a written partnership agreement.

The disadvantages of a partnership are again that all owners are subject to unlimited personal liability for the debts, losses, and liabilities of the business.

For me a partnership while it is cheap, easy to set up and has tax benefits, it has a high risk factor in that you are responsible for the actions of your fellow partners and debts if things go pear shaped!

### Private Limited Company

A limited company is a company which offers the liability protection of a corporation with the tax benefits of a partnership. It offers liability protection to its owners for company debts and liabilities and I think seems most appropriate for start up companies.

Limited companies are more expensive to set up than partnerships and have annual fees attached, but the benefits of this type of company for small start ups far outweigh the negatives.

Limited companies require few formalities such as annual meetings and benefit from a pass-through tax system (Similar to a partnership) which is good for small businesses.

There is also a public Limited Company structure, but this is so companies can be publicly traded on the stock market.

## **Chosen business structure**

We have chosen a Private Limited Company structure for Lightscape.

We have chosen the Limited Company because;

- They do not require annual meetings and require few ongoing formalities.
- Personal liability protection for owners for company debts
- A pass-through tax system meaning the business does not pay tax on its income, instead any profits or losses apply to the individual partners.
- The first £10,000 of a limited company's profits is tax free. (This is not the case for sole traders and partnerships)
- Company profits may be distributed as dividends to shareholders. Presently, National Insurance is not applicable to dividend payments, effectively reducing tax liability further.
- Operating as a limited company often gives suppliers and customers a sense of confidence in a business. Quite often, larger organisations in particular will prefer not to deal with non-limited businesses.

We feel all of these factors are the most appropriate and positive in helping us start up a small business. The tax benefits and liability protection alone are the biggest helps in making this decision and outweigh the negatives. However, while all of this sounds great, we must point possible negative attributes of such a structure, including:

- Limited Companies are more expensive to set up than partnerships.
- Limited Companies do not have a reliable body of legal precedent to guide owners although the law for limited companies is becoming more reliable as time passes.
- Limited Companies usually require annual fees and periodic paperwork.

Bearing in mind all of these aspects we feel that a limited company will offer us the best protection and its tax aspects on income will be the most beneficial for the company than anything else.

## Legal Requirements

The legal requirements of a Limited Company require a bit more investigation than a sole trader or partnership, but it is worth it considering the benefits.

### Requirements:

- The company must be registered at Companies House
- The company's annual accounts must be filed at Companies House
- An annual return form must be completed each year to ensure Companies House records the most up-to-date information about the company. This is subject to an annual fee.
- HMRC must be informed if the company has any profits or taxable income on an annual basis.
- Every limited company must complete an annual corporation tax return. Any liabilities must be paid within 9 months of the company year end.
- All company employees must pay income tax and NICs on any income they receive.

## Required company roles/people

Historically, all limited companies had to have a company secretary, but since April 2008, this is no longer a legal requirement due to measures contained in The Companies Act 2006. Now, a limited company can have a sole director - and no company secretary.

The current law states that there is no maximum amount of shareholders in a private limited company and it is possible for a company to have just one member, and for that member to have only one share.

The company must however have at least 1 director.

Source: <http://www.startinbusiness.co.uk/>

## Business registration costs

The standard fee to register with Companies house is £40 for standard paper registration, and there is a £15 filing service charge as well.

There are other costs involved (For example buying a printed certificate), but the initial cost of registration is very reasonable.

A full list of costs can be found here; <http://www.companieshouse.gov.uk/toolsToHelp/ourPrices.shtml>