

# What Form Should Your Business Take?

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## 1. Introduction

Many people want to start a business or may have already set up a business without really appreciating the different structures within which a business can be carried on or the legal implications of each business format.

There are a number of considerations to be addressed before a limited company, a partnership, a limited liability partnership or a sole trader can trade. All are different and there are advantages and disadvantages attached to each.

This leaflet is designed to briefly explore the legal requirements of each of the above formats and explain the differences. Taxation issues in respect of running your business will not be considered and you should take specialist accountancy advice in respect of such issues. We at Barlow Robbins LLP would be pleased to refer you to a suitable professional if required.

## 2. Sole Trader

You can commence business as a sole trader with the minimum of fuss. There is no specific law which governs the setting up of business as a sole trader, but a sole trader must adhere to general contractual and tax law.

A sole trader will trade in his or her own name and typically a business name is used (e.g. Mr John Smith trading as '*name of business*'). A sole trader is personally liable in respect of all contracts, liabilities and debts of the business. A sole trader is taxed in his or her own name.

## 3. Partnership

A partnership exists where two or more persons carry on a business in common with a view to a profit. It is sometimes the case, therefore, that a partnership may exist even if the parties or one party) does not consider that there is a partnership. Partnerships are governed by a law dating back to the 19<sup>th</sup> century, namely the Partnership Act 1890.

Partners have unlimited liability and all partners are liable for the debts of the partnership. One partner can enter into contracts on behalf of all the other partners. Each partner is taxed on his own earnings/ profit share.

The Partnership Act 1890 specifies default provisions which will apply to partnerships where no specific agreement to the contrary is made between the partners. The main default provisions relate to the sharing of profits and losses of the business equally between the partners. Also the partnership can be dissolved at any time if a partner leaves or dies.

As you can well imagine, the provisions of the Partnership Act are quite outdated and do not take account of the nuances of running and managing a business in the 21<sup>st</sup> century. There are no provisions which deal with disputes or exit routes for the partners.

We would recommend that a partnership agreement is entered into between the partners at the start of the relationship to avoid the default provisions applying.

#### **4. Limited Liability Partnership ('LLPs')**

An LLP is a hybrid between a partnership and a limited company. An LLP is a separate legal entity which can enter into contracts in its own name and is separate from its members. Members have limited liability (as the name would suggest). The owners and managers of an LLP are the same individuals. However, the members are taxed on their share of the profits, in the same way as a partnership.

To form an LLP, registration forms must be completed and a fee paid to Companies House. Each LLP, once registered, has its own unique registration number at Companies House. An LLP does not exist until an incorporation certificate is issued. An LLP must comply with ongoing filing requirements at Companies House, such as the obligation to inform Companies House of any changes to the members and it must file annual accounts and an annual return.

Members are subject to the same liabilities and duties as company directors. An LLP must also comply to a large extent to company law. This is the quid pro quo of the members enjoying limited liability.

The existence of an LLP will continue even if the members change. However, there must always be a minimum of two members, otherwise limited liability status will be lost after a period of time.

We would recommend, similarly to a partnership, that the members enter into an agreement to regulate their relationship as there is no statutory constitution which specifies how the internal affairs of the LLP should be managed.

#### **5. Limited Company**

A company limited by shares also has its own legal personality and can sue or be sued in its own right. A Company is managed on a day to day basis by its directors and is owned by its shareholders. The liability of the shareholders is limited to the extent of the shares which they hold and for which they have paid. Directors are not held personally liable for breaches by the company, except in certain limited circumstances which are described in our leaflet on the role and duties of a company director.

A company only comes into being when a certificate of incorporation is issued by Companies House after an application form and fee is paid. A company must have at least one director and one secretary. It must have at least one shareholder who must hold at least one share.

A company must comply with company law and keep its filings up to date at Companies House. A company is governed (in addition to company law) by its memorandum and articles of association which set out what the company can do and how its internal affairs must be managed.

A company is taxed on its own profits (corporation tax). Any profits to be paid to the shareholders are paid by way of dividend declared on the number of shares held by a shareholder. The payment of dividends is subject to income tax by the receiving shareholder, currently at a lower rate. Directors are usually employees of the company and must account for income tax on their remuneration.

**If you would like any further information, please contact [Sonya Gillespie](#) or a member of the Corporate Team.**