Company Formats and Business Structures Explained

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Until you start a business, you may not realise the number of business structures available in the UK, let alone the differences between them.

It might not be the most exciting topic to tackle, but your choice of business structure can make a difference to the profit you pocket at the end of the tax year.

Whether you're a sole trader with a simple structure, part of a partnership, or a director of a limited company, there are different legal requirements and tax structures to consider.

Check out the differences below but – with something this important - speak to an accountant before you make your final decision.



STEP 1 : What are the main business structures in the UK?

The main business structures in the UK are:

- Sole trader
- Partnership
- Limited company

You can find a detailed description of each format later in this guide.

Other structures include:

- Community Interest Company
- Unincorporated associations
- Different types of partnerships
- Overseas companies

You can find out more about these on the **Government website**.

Business formats: what's the difference?

Your business structure can impact the tax you pay and the control you retain. It may also affect funder and customer perceptions of your business.

STEP 2 : What business structure is right for me?

For solo entrepreneurs, it is a common misconception that a limited company is a big business only. We're so used to seeing Ltd at the end of the name of larger enterprises.

But an individual can register as a limited company if it suits their needs. And, after about £30k, it can make more sense financially than being a sole trader. However, there is much more paperwork and public scrutiny…

If you're not quite sure what sort of business structure if most relevant for your business, you could start with our guide on **How To Start Your Own Business.**

Pros and cons of different UK business formats

	About	Pros	Cons
Sole trader	If you run your own business and are self-employed, you're a sole trader by default. HMRC estimates almost 60% of businesses in the UK use this format	• Simplest form of business structure• Least admin of all structures• More privacy• Keep all the profit	• You are the business, meaning you're liable for any losses
Partnership	A partnership is much the same as being a sole trader…but there are two of you to share the responsibility of running the business	• Relatively simple structure• Less admin than a limited company• More privacy• Share all the profit	• You are the business. You're liable for any losses.• Additional partnership tax return to complete
Limited company	Limited companies aren't just for big businesses. Any company can register for this structure. You'll become an employee of the company	• You are separate to the business and have limited liability for any losses• Reduced tax liability in certain cases	• Subject to more public scrutiny / less privacy• More complicated structure and related admin



STEP 3 : Does business format affect the tax you pay?

Yes, your business format affects the type of tax you'll pay. The actual amount of tax will depend on a number of different factors, like your personal income, business profits, where you work from and what other sources of income you have (see below).

For limited companies especially, tax is an extremely complicated topic. So, it can be a good idea to hire an accountant to help you work out your liability.

	Sole trader	Partnership	Limited company
Taxes	You personally pay income tax on all profits after personal tax allowance is exceeded (currently £12,500 pa)	You personally pay income tax on all profits after personal tax allowance is exceeded (currently £12,500 pa)	Company pays business tax from first penny of profit. You also personally pay tax on any income you take from the business
Tax rate	• 20% up to £37,500• 40% from £37,500 to £150,000• 45% above £150,000	• 20% up to £37,500• 40% from £37,500 to £150,000• 45% above £150,000	• 19% flat rate



STEP 4 : Types of business tax explained

Income tax or corporation tax

If you're a sole trader, you pay **income tax** on your earnings. You have a personal tax-free allowance before you have to start paying (assuming you have no other sources of income).

Limited companies, on the other hand, pay 19% **corporation tax** on their profits. There is no personal allowance on corporation tax. It starts from your first pennies of profit! You also need to pay income tax

on any earnings you make from the business, such as a salary or dividends. Check out our article on **working out the tax for a limited company**.

Business rates

You may also be liable for business rates if you operate from business premises. This is basically council tax for businesses. Sometimes called 'non-domestic' rates, they apply to any building used for non-residential purposes. For example, offices, pubs, warehouses, holiday rentals etc.

Your business rates are set by the local authority where your premises are located. Each building has a 'rateable value' that your rates will be based on. You'll receive a bill in February or March each year. (Some premises are exempt or attract rates relief.)

National Insurance

National Insurance is paid to HMRC to pay towards certain benefits and the state pension. Your liability depends on your business status and income. If you're an employer, you'll need to take this from your employees' salaries using PAYE.

VAT

If your business earns more than £85,000, you have to charge **VAT**. Whilst this isn't a tax on you or your profits, it is money that you need to account for and pass on to HMRC.

What tax does a business pay?

It depends on your business structure, size and whether you work from premises.

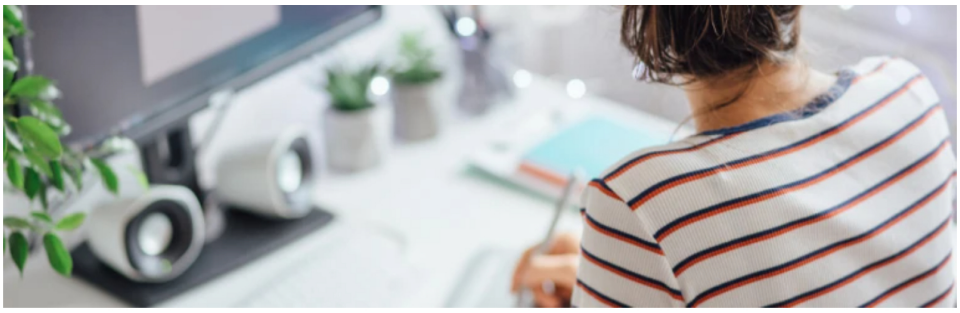
STEP 5 : What tax returns do startups have to complete in the UK?

Regardless of whether you hire an accountant or do it yourself, you need to keep detailed financial records and fill in the relevant tax returns on an annual basis.

The process is much more straightforward for sole traders than any other structure.

	Self-assessment tax return	Partnership tax return	Company tax return	Business accounts
Sole trader	Yes			
Partnership	Yes	Yes		
Limited company			Yes	Yes





STEP 6 : Registering as a sole trader

What is a sole trader?

60% of businesses in the UK are **sole traders** according to HMRC, so if you choose this format you're in good company.

People often think being a sole trader means you're the only person in your business. But that isn't the case.

Sole trader simply means that you are the exclusive owner of your business. You don't have:

- a business partner
- directors
- shareholders

If you are self-employed and make more than £1,000 a year from self-employment, you will need to register as a sole trader.

Can a sole trader employ staff?

Yes, a sole trader can employ staff. Think SOLE owner, not SOLO worker.

If you employ staff, you'll need to have a PAYE payroll scheme to manage income tax and NI contributions for employees.

What are the advantages and disadvantages of being a sole trader?

Life as a sole trader can be extremely rewarding. You call the shots and shape the business to suit your vision. But you also carry all of the responsibility on your shoulders.

Pros	Cons
Simplest structure – with just you at the helm, this is the simplest business structure. No partners, directors or shareholders to worry about. Just make your money, pay your staff and tax, and pocket the rest. Easy!	Personal liability – in the eyes of the law, you are the business. There is no legal distinction between you and it. This means you are personally liable for any losses the business makes. If you're starting a business where you might incur a high level of debt, registering as a limited company may offer you better financial protection if things go wrong
Less paperwork – unlike a limited company, you don't need to register at Companies House or log audited accounts. You just need to register with HMRC and complete a single tax return each year	Public perception – because it is so easy to set up as a sole trader, they aren't always viewed the same way as limited companies. You may find some banks, clients – and even search engines – prefer to deal with limited companies
More privacy – apart from you, your accountant and HMRC, nobody needs to know anything about your business	

Keep all the profit – Any profit the business makes is yours to keep	
Retain control – you retain full control of your business and how you run it	
Benefits – by agreeing to pay voluntary National Insurance contributions, you can become eligible for certain state benefits	

In good company

60% of UK businesses are registered as a sole trader.

How do I register as a sole trader?

To **register as a sole trader**, you complete an online form with HMRC to register for tax self-assessment.

You'll need:

- A Government Gateway account to use the HMRC website
- A National Insurance number
- Details about you and your business
- An eligible business name

You can begin trading immediately. Your first formal encounter with HMRC as a sole trader will come when your first self-assessment tax return is due.

Find out more on the Gov.uk **Set Up As A Sole Trader** page.

What tax do I pay as a sole trader?

This structure makes life easier for tax. You'll still need to keep detailed financial records but there is far less HMRC-related admin.

As a sole trader, you will need to:

- **complete an annual self-assessment tax return**
- pay income tax on the money you make
- pay (voluntary) National Insurance contributions

If you exceed the **VAT** threshold – currently £85,000 a year - you'll also need to register for VAT.





STEP 7 : Registering as a partnership

What is a partnership?

The friendliest sounding of all the business structures, a partnership means you own a business equally with someone else. You share the responsibilities, risks and profits between you.

As with sole traders, the partners are the exclusive owners of their business. You don't have:

- directors
- shareholders

What are the pros and cons of registering as a partnership?

Having a partner to share your startup adventure with can make the process less daunting. Two heads can be better than one; a partner is someone to bounce ideas off and make big decisions with.

But there is more paperwork to complete and more complicated tax considerations.

Pros	Cons
Simple structure – after sole trader, this is the simplest business structure. You don't have directors or shareholders to worry about. Just make your money, pay your staff and tax, and split the profit between you	Personal liability – in the eyes of the law, you are the business. There is no legal distinction between you and it. This means you and your partner are personally liable for any losses the business makes. If you're starting a business where you might incur a high level of debt, registering as a limited company may offer you better financial protection if things go wrong
More privacy – apart from you and your partner, your accountant and HMRC, nobody needs to know anything about your business	More paperwork – compared to sole traders, you've got more paperwork. You'll need to register with HMRC for tax self-assessment and for a partnership tax return
Play to your strengths – a partnership can mean you split the workload and play to your individual strengths. For example, one partner can handle finances whilst the other manages the marketing	Partner problems – you need to be really sure about the person you go into business with! You need to be able to trust them with financial and professional affairs. Partnerships can end up in legal dispute
Retain control – as partners, you retain full control of your business and how you run it	Share control - day-to-day you want to be on the same page as your partner, otherwise making decisions and setting direction can be difficult
Benefits – by agreeing to pay voluntary National Insurance contributions, you can become eligible for certain state benefits	

Share the successes

Registering as a partnership means you'll share the successes - and stresses - of business ownership with another person.

What tax and admin are partnerships liable for?

In a partnership, each partner is classed as self-employed and needs to complete an individual tax

return. You'll be liable for paying any tax and National Insurance contributions on your share of the business.

You also need to complete a partnership tax return and will face a fine if you don't.

As with sole trader status, you will have further tax liabilities if you employ staff or exceed the VAT threshold.

Because you remain personally liable for any loans or losses, you may find registering as a limited company offers better financial protection.

How do we register as a partnership?

There are two steps to registering a partnership. Firstly, you need to register the partnership for tax self-assessment. You do this online and will need a Government Gateway account to use the HMRC website. Or you can download and **complete a hard copy form**.

You'll need information including:

- Details about the partnership – name, address etc
- The type of partnership you're registering for
- Details for a 'nominated' partner who deals with the paperwork

Then you'll each need to register individually for tax self-assessment.

What's the difference between different types of partnerships?

There are various other types of partnership, where partners are not equally responsible for the business.

These are called 'limited partnerships' and 'limited liability partnerships'. Find out more about these on the HMRC website.



STEP 8 : Registering as a limited company

What is a limited company?

Entrepreneurs and small business owners often think that only big businesses can be limited companies

Entrepreneurs and small business owners often think that only big businesses can be limited companies. That isn't the case; any business can register as a limited company.

The word 'limited' just means that you have LIMITED liability for losses because you – and your personal finances - are separate to the business in the eyes of the law.

There are different types of limited company.

Private limited company (Ltd)	**Public limited company (PLC)**	**Limited by guarantee (LBG)**
A private business that make a profit	A business that makes a profit but offers shares to the public	A 'not for profit' business
The company:• is legally separate from the people who run it• has separate finances• keeps any profits it makes after paying tax	The company:• is legally separate from the people who run it• has separate finances• offers share to the public• keeps any profits it makes after paying tax	The company:• is legally separate from the people who run it• has separate finances• has guarantors who agree to pay a set amount of money towards any debts• invests profits it makes back into the company

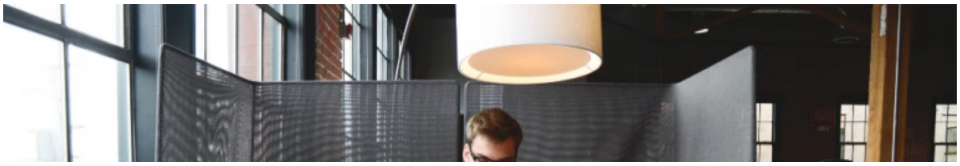
Don't get fined

You must register your limited company within three months of trading or face a fine.

What are the pros and cons of registering as a limited company?

As you can tell, this is complicated stuff. An accountant will be able to help you decide whether registering as a limited company is the best option for your business.

Pros	**Cons**
Limited liability - Limited companies and their owners are separate legal entities. This means you won't incur any losses if your business runs into financial difficulties	Complicated structure – There's a reason that many businesses have a well-paid Company Secretary to keep them straight. This structure – and legal requirements – can be complex
Public perception – Due to the paperwork and public scrutiny associated with limited company status, they're generally considered more trustworthy. As a result, you may find it easier to get finance, find clients and even rank more highly in search engine results	More paperwork – Compared to sole traders and partnerships, you'll have a lot of paperwork, including preparing audited accounts each year
Tax benefits – after a certain level, a limited company can be a more efficient tax structure than a sole trader or partnership. This means you may have more money in your pocket	Less privacy – You'll have to register with Companies House and your details will be on public record, as will your business finances
Parental / sick pay – it'll take an accountant to explain this properly but there are some small financial benefits should you need to be off work for parental or health reasons	Less control - day-to-day you want to be on the same page as your partner, otherwise making decisions and setting direction can be difficult
	Split the profits – you'll be able to take a salary, maybe dividends, but you may also need to think about payouts to shareholders…
	Share control – if you do have shareholders or a board of directors, you won't have as much say over your business anymore





What tax and admin are limited companies liable for?

Limited companies can be more 'tax efficient' than other business formats. But there is much greater scrutiny and admin associated with this business format.

They have to:

- be registered at Companies House
- submit annual accounts and be audited each year
- have at least one director (you)

As a director of the company, you will:

- pay income tax on your salary
- be taxed on any dividends you take
- pay your own National Insurance contributions

The company itself will need to:

- pay corporation tax
- deduct and pay employees' taxes and National Insurance contributions

Learn more about **how to calculate limited company tax**.

How do I register as a limited company?

You register for both Companies House and corporation tax at the same time, via the Gov.uk website. It costs £12 and usually only takes 24 hours.

You can also register by post or through an agent. If you don't want Ltd in your business name, you need to register by post and it costs £40. Don't ask us why!

You'll get a 'certificate of incorporation' that:

- Proves your company legally exists
- Records the company name
- Shows the date of formation

Within three months of trading, you'll also need to register for corporation tax too.

If you'd like any further information on starting a business, you can find our full collection of start up guides, here.

If all this has brought you one step closer to figuring out your new business venture, take a look at

our Start Up Loan calculator to see how much you could borrow.

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