Business Structures and Registering with HMRC

Introduction

When starting your new business you'll have to decide which legal structure it will have. You should carefully consider the issues involved, such as your own liability for future business debts, and the tax implications of your chosen structure.

In this guide, we'll introduce the main legal structures. These are sole trader, ordinary partnership, private limited company, limited liability partnership (LLP) and community interest company (CIC).

Sole trader

Sole traders are treated by HM Revenue & Customs (HMRC) as self-employed for tax purposes. If you are a sole trader, you retain all your business profits after tax but are also personally liable for the debts of your business. This means that your home and other personal assets may be at risk if you can't pay your business's debts.

Sole traders must register with HMRC for tax self-assessment as a self-employed person. They must also complete an annual self-assessment return, and pay income tax and National Insurance contributions.

Find out more about setting up as a sole trader.

Partnership

An ordinary partnership, or simply a 'partnership', is two or more people trading in common with a view to profit. Business that will be owned by two or more sole traders often use this structure. You don't need to register this type of partnership with Companies House.

You and your business partners have unlimited liability for the debts of your business. You can each be held responsible for transactions or contracts entered into by any of your other business partners.

Partners are treated by HMRC as self-employed for tax purposes in the same way as sole traders, and retain and share all their business profits after tax. Partners do not all have to be individuals, as a private limited company is treated in law as a 'legal person' that can also enter into a partnership.

If you decide to go into a partnership, it is best practice to ask a solicitor to draw up a partnership agreement before starting to trade. The partnership agreement clarifies each partner's legal position and provides a framework for dealing with any problems that may arise.

Find out more about setting up a partnership.

Private limited company

A private limited company has a separate legal identity to that of its owners. This means that you and the other owners of the company, who are called 'members', benefit from limited liability. Your company itself can own property and other assets.

A private limited company must be incorporated with Companies House and registered with HMRC. It can be limited by shares, which means that your liability and that of other members is limited to the money you have each invested buying shares in the company.

It can also be limited by guarantee. This means that your liability is limited to the amount you have agreed to contribute to your company's assets if you wind up your company.

Find out more about setting up a limited company.

Limited liability partnership

A limited liability partnership (LLP) is a legal structure that lets you set up in business with one or more partners while limiting your personal liability. An LLP is similar to a private limited company in that it has a separate legal identity to that of the partners (who are known as 'members').

In many ways, LLPs operate in exactly the same way as ordinary partnerships. However, you must register LLPs with Companies House.

Members of an LLP can be either individuals or limited companies (known as 'corporate members'). Individual members will usually be treated as being self-employed for tax purposes, and must be registered for self-assessment with HMRC. You and other members act as agents for the LLP and can form binding contracts on its behalf.

Each LLP must have at least two 'designated members' who are responsible for various administrative duties such as dealing with accounts and tax matters on behalf of the partnership.

Since the LLP has a separate legal identity to its members, legal claims against your business can only be made against the LLP itself and not you as a member. Your personal assets also cannot be seized to settle the partnership's debts.

Management of the partnership is usually shared among the members, as specified by an LLP agreement. This is a contract between the members of the LLP, which sets out members' rights and obligations. It also provides a plan for how you will run the partnership. It is best practice to ask a solicitor to draw an LLP agreement before starting to trade.

Find out more about setting up an LLP.

Community interest company

A community interest company (CIC) is a specific type of limited company that trades commercially as a social enterprise and has clear social objectives, such as providing employment opportunities for people with disabilities.

CICs must be registered with the Office of the Regulator of Community Interest Companies and pass a 'community interest test' before being approved. This test ensures that activities of a CIC provide benefits to the community.

You can set up new CICs as private companies limited by shares, or as private companies limited by guarantee.

CICs that are limited by shares and that make a profit can distribute some of their profits to shareholders, subject to certain conditions. There are restrictions on the distribution of profits to shareholders to ensure that CICs use their assets and profits for the benefit of the communities they serve.

Find out more about setting up a CIC.

Hints and tips

- Solicitors and accountants can help you make decisions about legal structure, as well as helping with the practical procedures involved in setting up more complex structures such as LLPs and private limited companies.
- As your business grows, you might need to review your structure to meet changing business needs.
- It is possible to change the legal structure, but this may cause problems by disrupting business activities and it can be costly and time-consuming.