Ways to structure a business

When setting up a business the structure that you adopt will define the legal liabilities which you may face in running one. It depends on the circumstances as to which business structure is the most beneficial since there are wide differences between them. This guide only touches on some of them.

Usually the overriding aim will be to achieve limited liability, which will mean that the incorporation of a company is the main option (although this can also be achieved by setting up a limited liability partnership). If limited liability is not important, then tax factors will be the driving force. It is important that you get both accounting and legal advice as to the best structure for your business.

The main types of business structures are:

- a sole trader
- a limited company
- a partnership
- a limited liability partnership
- an unincorporated association.

Sole trader

As a sole trader, you are running the business as an individual. There is no separate entity which runs it. You keep all your business profits and you pay tax on them. As a sole trader you are responsible for the liabilities of the business. You are therefore personally responsible for any losses that it makes.

Limited company

If you set up a company this will be a separate legal entity in its own right and it will have its own benefits and liabilities. The finances of the company are separate to your personal finances.

Any profit made in the business will be owned by the company (subject to tax). The company can then distribute its profits to the shareholders by way of dividend, and when the company is wound up its capital (after deducting all liabilities to third parties) will be divided amongst the shareholders in proportion to their shareholdings.

A company is made up of:

- **Members -** are the people who own the shares in the company and are also known as 'shareholders'
- **Directors -** are responsible for running the company. Sometimes shareholders are also directors but they do not have to be. There are many legal responsibilities which are placed upon a director in running a limited company.

Most companies are 'limited by shares'. This means that the shareholders will only be liable for the company's debts limited to the value of the shares that they own but have not paid for.

As shares are usually paid for on incorporation, a shareholder will therefore have no liability for the company's debts in normal circumstances. The directors will not be responsible for the debts of the business (unless they have breached their director's duties or broken the law in some other respect eg by fraudulent or wrongful trading).

A company can also be 'limited by guarantee'. This means each member undertakes to pay a specific amount if the company is wound up whilst he is a member, or within a year after he ceases to be a member. Most companies limited by guarantee are charities or other non-trading companies.

A company can also be a 'public limited company'. The aggregate nominal value of all shares in issue must be at least £50,000, with at least £12,500 worth of shares having been paid for by the shareholders.

Public companies are more regulated than private companies. Probably, the principal reason to choose a public company structure is that they can issue shares to the public.

Partnerships

If you decide to set up a partnership you and your partners will be personally responsible for the business. Unlike a limited company, a partnership is not a separate legal entity in its own right. This means that all the profits of the business are shared between the partners.

However, you will also be personally responsible for the share of any losses that the business makes and also for all debts incurred on behalf of the business.

Limited liability partnerships

If you set up a limited liability partnership (LLP) the members of an LLP are not personally liable for the debts of the business. If the LLP cannot pay, their liability is limited to the amount which they have invested in the business.

The LLP is like a company in some ways, as it is a legal entity in its own right, but like a partnership in other ways. For example it does not have shareholders or directors and members are taxed on the LLP's profits as if they were partners.

The LLP is governed by what is known as an LLP agreement. This document normally sets out the member's shares of the LLP's profits and liabilities. It governs the running of the LLP. There are also designated members in an LLP who have extra responsibilities under the LLP agreement.

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Unincorporated association

Although unusual, an unincorporated association is an organisation set up by agreement between a group of people who come together for a reason other than to make profits, such as a sporting club.

Individual members will be personally responsible for any debts or contractual obligations of an unincorporated association.

Contact

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