

STARTING UP

Sole Trader, Partnership or Company?

How the three main ways of trading compare on tax, liability, paperwork and credibility, and how to choose the one that fits your plans.

FOR: START-UPS AND PEOPLE GOING SELF-EMPLOYED · NEW TO BUSINESS

Why the structure matters

Most people start trading under whichever structure is easiest on the day, then discover it was not the best fit. The structure decides who is legally responsible for the business's debts, how profits are taxed, how much paperwork you carry, and how the business looks to banks, customers and investors. It can be changed later, but changing costs time and sometimes tax, so a little thought at the start is worth it.

The three main options

Sole trader

You and the business are the same legal person. You keep all the profit, and you are taxed on it through Self Assessment whether or not you take it out. There is little set-up and little public filing. The trade-off is unlimited personal liability: if the business cannot pay its debts, your own assets are at risk.

Partnership

Two or more people trading together. Each partner is taxed on their own share of the profits, and a partnership return is filed alongside each partner's personal return. In an ordinary partnership each partner is personally liable for the firm's debts, including those caused by another partner. A written partnership agreement is strongly advisable; without one, the default rules in the Partnership Act apply, and they rarely match what the partners assume.

Limited company

A separate legal person, owned by shareholders and run by directors. The company's debts are its own, so your personal exposure is normally limited to what you have invested, unless you have given personal guarantees or acted improperly. The company pays corporation tax on its profit, and you are taxed personally on whatever you take out as salary or dividends. The price is more admin: statutory accounts, a confirmation statement, and public filings at Companies House.

What a limited liability partnership is

A limited liability partnership, or LLP, sits between the two: members have limited liability, but the LLP is taxed like a partnership. It suits some professional and investment businesses. It carries similar filing duties to a company.

Who this is for

- Anyone about to start trading
- Sole traders wondering if they have outgrown their set-up
- Friends or family planning to go into business together

Key points

- Liability is the biggest practical difference. Tax is only part of the picture.
- A company is cheaper to get wrong than to put right later.
- Partners need a written agreement, however well they get on.
- Think about the next three years, not just the first three months.
- Take advice before you register. It is much easier than unwinding it.

How to choose

Work through four questions.

1. **What could go wrong?** If the business signs leases, borrows, holds stock or takes on staff, limited liability is worth a lot. If you are a consultant with few commitments, the risk may be low.
2. **How much profit will you take out?** At low profits, a sole trader's simplicity usually wins. As profit grows, a company can offer more flexibility in how you take income, though the saving varies with your own circumstances and with the tax rules in force, which change often.
3. **Who will you trade with?** Some customers, lenders and contracts prefer or require a limited company.
4. **What is the plan?** If you intend to bring in partners, raise money, employ people or sell the business, a company is usually easier to bring investors into, share ownership of and eventually sell.

Questions to ask yourself

- What happens to my home or savings if this goes wrong?
- Will I sign leases, loans or long contracts?
- Will anyone else own part of the business?
- How much profit do I want to leave in the business?
- Do customers or lenders expect a company?
- Do I plan to sell one day?

What it costs to run

A sole trader files an annual tax return and keeps records. A partnership adds a partnership return and the agreement. A company adds statutory accounts, a corporation tax return, a confirmation statement, a register of people with significant control, and payroll if you pay yourself a salary. None of this is difficult, but each item has a deadline and a penalty if it is missed.

Changing later

You can start as a sole trader and incorporate when the business justifies it, but moving the business into a company can have tax consequences for assets and goodwill, and contracts, bank accounts and registrations need to be moved or updated. If you expect to incorporate within a year or two, it is often simpler to start as a company.

Before you decide

Write down what you expect to earn, what you will owe suppliers, who else will be involved and what you would like to happen if you wanted to sell or step back. Bring that to a conversation with your accountant, and we can show you the figures side by side for your own numbers.

Related guides

If this is useful, you may also want:

- Registering your business
- Your first year in business
- Paying yourself

How King Street can help

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We compare the structures for your own figures, set up the company or partnership, prepare the partnership agreement or articles, and make the registrations with Companies House and HMRC, so you start with the right foundations and a clear calendar of deadlines. Tax decisions are tested against your personal position before you commit.

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