6.2.6. Sole Trader / Partnership v Limited Company

Thinking of setting up a new business? Unsure whether to register as a limited company, or operate as a sole trader or partnership?

This comparison illustrates the main differences between a business run by a sole trader or partnership and a company managed by its owner director/shareholder.

As you will see, there are significant differences in the way remuneration is taken and the tax and NIC implications.

In order to make a properly informed decision we would recommend you talk with us so that we can work out the format that is best suited to your circumstances, and will provide the maximum personal income with the least tax and NIC liability.

Sole Trader or Partnership	**Limited Company: you are director & shareholder**
You are the business	The business is a separate legal entity
You are the owner	You are the shareholder
You are the manager/proprietor	You serve the company as its director (and perhaps company secretary too)
Employment status: • You are self-employed. • You cannot also be an employee.	Employment status: • A director is an office holder. This does not automatically make him an employee in terms of employment law. • For tax and National Insurance purposes company officers are generally taxed as employees.
Tax on profits: • You pay Class 2 & 4 National Insurance and Income Tax on taxable profits, or your share of profits. • Your top rate of tax is 50%	Tax on profits: • The company pays Corporation Tax on its taxable profits. Company tax rates are lower than higher rates of income tax. • Employees and office holders are subject to PAYE and NICS on their pay and most benefits in kind • Shareholders pay higher rate tax on dividends. • When IR35 and the Managed Service Company provisions apply, the company must deduct PAYE and NICs on the income affected.
Losses:	Losses:

• You can offset your trading losses against your other income.	• The company can offset its trading losses against its other income, but not against your income as an individual.
Extracting profits • You may withdraw cash from the business without tax effect.	Extracting profits You are taxed on: • Any income withdrawn from the company. If it is a distribution it is taxed as a dividend. If it is earnings it is under PAYE and subject to NICs. • Most employment benefits received by you or your family and household are taxable (subject to tax-free exceptions). • Shares or securities in the company which are given to you at less then market value.
Borrowing • You are free to borrow from the business bank account. After all, it is your account.	Borrowing A director may borrow from his own company. Limits are set by Companies Act 2006, but there are tax costs: • The company will pay a tax charge of 25% if you borrow from the company and do not repay the loan within nine months of the year end. • If the loan is interest-free there will be a taxable benefit in kind for the director.
Pension • You can only have a Personal Pension.	Pension • Company schemes may be far more generous in terms of benefits and limits than Personal Pension. • A SIP or SAS, or an unapproved scheme may be used to hold assets used in the company and may have flexibility on borrowing multiples. • Stakeholder Scheme pensions must be available when you employ 5+ employees.
Insolvency • If the business fails you will be personally (or jointly with your partners) liable for its debts.	Insolvency • If the company fails, your liability is limited to the amount unpaid on your shares (if any) unless you have made a personal guarantee (which is often required by banks).

	• As a director you can be held personally accountable if you continue trading when your company is insolvent and this causes financial loss to creditors. This could result in your personal bankruptcy.
Accounts • You prepare annual accounts for your personal tax return (Self Assessment). They can be in a very basic format. • Your accounts are not submitted to HMRC unless you are subject to an investigation. • Your accounts must be prepared in accordance with accounting standards.	Accounts • You prepare annual accounts under the provisions of the Companies Act. These can be abbreviated for filing with Companies House. • HMRC requires full accounts for Corporation Tax which must be submitted using its own or specialist software. • Accounts must be prepared in accordance with accounting standards.
Selling the business When the business or assets used in it are sold, you are personally taxed on any gain under the Capital Gains Tax (CGT) rules. • A disposal with gains of up to £5 million may qualify for Entrepreneurs' relief	Selling the business When the business or its assets are sold, there is a double tax charge on shareholders. The company pays corporation tax on any profit that it makes on disposal. The shareholders are taxed on the distribution of the proceeds. • It may often be more efficient to sell the shares in a company, rather than its trade or business, or individual assets. • Company shares can be gifted. • Providing you own more than 5% of a trading company, a disposal with lifetime gains of up to £10 million may qualify for Entrepreneurs' relief.
Death • When you die your business ceases. You can pass all or part of it down to the next generation. • In a partnership you can pass on your share of the partnership. • Business Property relief (PBR) will apply for inheritance tax (IHT) purposes if the business is a	Death • When you die the company continues as it is a separate legal entity. • The company's shares will qualify for BPR for IHT purposes, providing the company is engaged in trade. • There is no IHT relief on outstanding directors' loans. • Assets that are held outside the business qualify for 50% BPR.

qualifying trade.	
Paying yourself • You can withdraw any amount of profits, but it is not classed as remuneration as you are not an employee. • Paying a salary to a spouse or family members must be commercially justified to be allowable for tax purposes.	Paying yourself • There is no restriction on the size of your salary, but it is subject to PAYE and NICs. • Paying a salary to a spouse or family members must be commercially justified to be allowable for tax purposes. • If your contracts are under IR35 or the company is a managed service company PAYE and NICs will apply to income.
Expenses in general: • You can obtain tax relief for expenses that are incurred wholly and exclusively for the purposes of your trade. • If you can identify a proportion of an expense that relates to business you can claim the same proportion against tax. • An adjustment must be made for tax to add back the proportion of any expense that relates to "private use". • Most commonly private use will be things like use of your telephone or power, own consumption of goods, and motor running expenses.	Expenses in general: • The company obtains tax relief for its expenses if they are incurred wholly and exclusively for the purposes of the trade. • If a director incurs private expenses paid through the company, they are treated as earnings. • Alternatively, private expenses can be used to offset a loan made by the director to the company. • Private payments may also be treated as distributions or dividends.
Cars and fuel • A sole trader or partner can claim capital allowances on a car, disallowing a proportion for private use. • Low-emission cars can be tax efficient for family members on the payroll. • There is no adjustment for fuel benefit for you as a sole trader.	Cars and fuel • The company obtains full capital allowances on cars, irrespective of any private use by employees. • Cars may be expensive as benefits in kind but this depends on list price and the CO_2 emissions of the vehicle. • It may be better to use your own car and be reimbursed by the company using HMRC's Authorised Mileage Rate. • Low-emission cars can be a tax break for family

You simply disallow a proportion of your fuel costs in relation to private use.	members on the payroll. • It is not tax efficient to provide fuel for private use.
Mobile phones • Mobile phones will be subject to private use so a tax add-back is expected on your tax return.	Mobile phones • Mobile phones can be provided if the contract is in the company's name, tax free. • Only one per household.
Computers • You can obtain capital allowances on a computer. An add back of allowances will apply if there is substantial private use.	Computers • Providing you need to use one to perform your role your company can provide a computer without any tax consequences.
Tax-free benefits and incentives • These do not apply to the self-employed	Tax-free benefits and incentives • Many different benefits and employment incentives can be provided free of tax (the company will obtain tax relief on the cost of providing these too).
Working from home • You will be able to claim a deduction for mortgage interest, rates and light and heat, if you have an office at home.	Working from home • You can claim £3 per week without receipts for home expenses. • Alternatively, the company can reimburse you for light and heat, but not mortgage interest or council tax.
Charging rent for use of home • A sole trader cannot charge himself rent.	Charging rent for use of home • As a director you can set up a licence between you and your company to rent an office in your home. This will enable you to recharge a proportion of mortgage interest and council tax. • You will need to prepare rental accounts as an individual for your own tax purposes.