



Types of Business Structure

This chapter gives a brief introduction to the different legal frameworks for business. Businesses need to make sure they have the right legal structure to suit the way they do their business. Some of the things affected by the type of business structure chosen are:

- Tax and National Insurance that should be paid
- Records and accounts to be kept
- Financial liability if the business runs into trouble
- Ways the business can raise money
- Ways in which management decisions are made about the business

The main types of legal frameworks for businesses are as follows:

Sole Trader

This is the simplest form of business, and there are very few formalities to be complied with. The individual has the full responsibility for running the business and takes any of the profits. He or she will also be personally liable for income tax, value added tax, capital gains tax and all the debts incurred in running the business. If these debts cannot be paid, one or more of the creditors may seek to have the owner declared bankrupt. Sole traders often trade under their own name, with their own money or with relatively small sums borrowed from banks or other lenders. Being a sole trader is a risky option for a business that requires a lot of financial investment. The fact that the business is a 'sole trader' does not

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mean that the trader cannot employ other people. It simply means that it is structured as a business with only one owner.

A sole trader:

- a) owns the business and is personally liable for its debts. If the sole proprietor becomes insolvent (either through the business debts or by way of personal debts) and is declared bankrupt, then the business will come to an end.
- b) has complete control over the business and is answerable to no one else in the running of it.

A sole trader must fill in an annual self-assessment tax return to HM Revenue & Customs and must also keep records showing all of the business income and expenses. If his or her turnover (not profit, but turnover) exceeds a specified sum for the relevant tax year, then the owner must pay VAT on all his or her sales. The sum can change from year to year and is announced in the annual budget. Different rates of VAT apply to different types of goods and services. Some goods and services are exempt from VAT or subject to VAT at a reduced rate. Accordingly, there are three VAT rates: the 'standard' rate, which is currently 20 per cent, the 'reduced' rate at 5 per cent and a 'zero' rate at 0 per cent. These rates of VAT may change from time to time – the changes are also usually announced in the Budget.

When a Sole Trader dies, the business ceases unless it is specifically bequeathed by way of a Will –in which case the beneficiary will take over the business. If the sole trader dies intestate (i.e. without leaving a Will) the business as a whole, or the individual assets of the business, can be sold by the Personal Representative/s (i.e. the person/s having the power to wind up and distribute the estate).

It can be seen, therefore, that a sole trader:

- Is the sole owner of the business and its assets and income.
- Is the sole decision maker of the business.
- Is responsible for paying income tax on the profits of the business, PAYE in respect of his/her employees and
- Has unlimited personal liability for the debts of the business.

There are no formalities for starting up a 'sole trader' business, i.e. it does not have to be structured in any particular way, nor does it have to be registered anywhere. However, if someone wants to carry on business under any name other than his or her own personal name, then that name has to be in accordance with legislation – see later.

Partnership

The Partnership Act 1890, s.1 defines a partnership as “the relationship which subsists between persons carrying on a business in common with a view of profit”.

A partnership is a business with two or more owners, who share in the management, profits, losses and risks involved in being in business. There is no limit to the number of people who can go into partnership with each other, but the more partners there are, the more complicated the management of the business.

Usually, each partner shares in the decision-making and is personally responsible for any debts that the business runs up. Like a sole trader, a partnership does not have a legal existence separate from the partners. Even if the partnership operates under a business name which is different from the names of the partners, this is only a convenient way of collectively describing the individuals, since all rights and liabilities attach to individual partners.

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If one of the partners resigns, retires, dies or goes bankrupt, he or she will usually be bought out by the remaining partners so that the partnership continues, this will usually be a provision in the Partnership Agreement. If there is no provision, then the partnership would have to come to an end – it would have to be dissolved.

No formalities are required to create a partnership. In fact, when two or more people carry on a business together, the law will regard them as a partnership, even if there is no apparent agreement between them. Of course, in most cases when people take a conscious decision to set up as partners, they will enter into a written Partnership Agreement dealing with, for example, provision of capital, division of profits and losses, pension arrangements, and so on. The partners will divide the profit and general losses of the business between them. In a small partnership this would probably be equally, but in a larger partnership the division of such profits and losses may not be equal (depending, for example, on the amount each partner contributed to the capital of the business).

If all small businesses are taken into account, partnerships are much less common than sole traders or limited companies. However, in the financial services sector and the professions, for example, solicitors, accountants, auctioneers and estate agents, a partnership is the usual form of business structure.

Here are some key points to remember about partnerships:

- Partners themselves usually manage the business, though they can delegate responsibilities to employees.
- Partners raise money for the business out of their own assets and/or with loans.
- It's possible to have 'sleeping' partners who contribute money to the business but are not involved in running it.
- The partnership must keep records showing business income and expenses, but there is no legal requirement that the partnership's accounts be filed anywhere or made available to the public.
- The partners are taxed separately as self-employed individuals, paying income tax on their share of the profits of the partnership. However, the partnership must notify HMRC of the identity of the individual partners.
- The partnership is subject to VAT on the value of the turnover of the business in like manner to that of a sole trader.
- The general partnership as a whole has no separate legal status (unlike a limited liability company – see later), and the partners therefore have unlimited liability for the debts of the partnership. This means (just like a sole trader) if the partnership fails or even has large unpaid debts, then the creditor/s can pursue not only the assets of the partnership as a whole, but the personal assets of the partners themselves. There used to be an old saying that each partner would be liable for the debts of the partnership "down to his last brass farthing" (a farthing used to be a monetary coin representing a quarter of an old penny and would now be worth the equivalent of one-ninth of our current 1p piece). This means that each partner is totally liable for the partnership debt, just like a sole trader is. This is called a "joint and several" liability – each partner is both jointly liable with the other partners and also individually liable. This, for example, allows a creditor the choice of seeking the full amount of the debt from one individual partner, from a few partners of his choosing or from the partnership as a whole.

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Coursework Sample

Assignment

1. What is meant by 'Limited Liability'?
2. What is the 'Veil of Incorporation' and in what situation or situations might a Court lift that veil?
3. What is meant by 'passing off'?

This assignment includes 25 questions in total and is designed to assess learners' knowledge and understanding of the subject. Guidance is provided on how to write assignments.