Different business structures

Business

There are many types of organisational structure a business may decide to adopt. This assignment will examine the four main different business structures and present the advantages and disadvantages of each one. The business structures that I will be examining are as follows: A sole trader is an organisation, which is owned by one person. The assets and liabilities of the owner and those of the business are the same. There are no legal or tax distinctions between the owner and business. This type of business is straightforward to set up and dissolve.

It requires the minimal legal requirements and costs. The owner can make all the decisions and can retain all the profits. He owns all the assets of the business. The owner can draw or invest funds into or out of the business, as he deems necessary. Business losses can be offset against other income, including claw back of past pay as you earn (PAYE). As the sole trader is self-employed, he is able to defer Income Tax and reduce his National Insurance contributions. The owner" s personal assets can be transferred to a spouse (or any other relative).

However, the assets may be required to be returned by the court if it is satisfied that they were transferred to defeat creditors that were owedmoney. There is no legal requirement to have the accounts and records audited. No public disclosure of accounts and records is necessary, unless the business is registered for Value Added Tax (VAT). There is no requirement to register for VAT unless the taxable supplies to customers is equal to, or exceeds, the registration level. The registration level is currently ? 50, 000 for a twelve-month period). The main disadvantage for being a sole trader is the unlimited liability factor.

The sole trader is putting at risk his entire personal fortune including his house, car and any other personal assets in his possession that are outside the business. This is because there is no distinction between the individual (the owner) and the business. The law does not recognise the business as an artificial person (unlike a company,) and the business therefore, does not receive the benefits that would be attached if it were. If the business does become bankrupt, the owner may loose his personal fortune to pay the debts of the business. It is also true that if the sole trader becomes bankrupt, the business cannot legally continue.

There are no additional funds available from equity investment by persons outside the business (third parties). This therefore, limits the businesses" growth potential. The transfer of ownership is not very flexible and the owner can only sell assets. All of the profits from the business are taxes as personal income, whether they have been retained within the business or taken out. Although self-employment reduces the National Insurance contributions payable, it also reduces the benefits of the National Insurance entitlements. The tax relief on pension contributions is restricted.

If any property is transferred to the spouse it is lost to the sole trader if the marriage breaks and the spouse refuses to give it up. If the owner dies, the business comes to an end and the executives in charge of his affairs either sell it as a going concern or sell the assets individually. This is easy to set up and dissolve. There are no legal requirements to audit the accounts. No public access to the accounts ensures confidentiality. Any business losses can be offset against other income. Can be converted to a limited company

at a later stage. Benefits of self-employment for income tax and National Insurance.

Can attract more capital by admitting new partners, however, each partner has the right to veto the introduction of the new partner. Can get credit easily because supplies are not at risk as it is the partners who are taking the risks. A partnership can sue (and be sued) in its own name even though it is not an artificial person. Can change s19 of the Partnership Act 1890, but all partners must agree (s24 of the Partnership Act 1890). Can change provision of the 1890 Act e. g. s24 – profit and losses shared equally, but partners may provide for a different share (e. g. ?: ? rofit liability) in their agreement.

If no evidence of split, their split will be equal. Every partner has legal access to inspect and copy firms books s24 (9) Partnerships Act 1890. Differing salaries may be given to partners before surplus profit is split. No doctrine of ultra vires and partnership may engage in any lawful activity as the partners" see fit. Able to access knowledge and experience of the partners. Limited to maximum of 20 people by Companies Act 1985, some professions are exempt and can have partnerships of unlimited size (e. g. solicitors, accountants, estate agents, stock brokers).

Partnerships are jointly and severally liable for debts. Liability extends to private assets/personal fortune. Bankruptcy of partnership equals bankruptcy of all partners (excluding limited partners under the Limited Partners Act 1907). If a partner dies, his estate may still be liable for the businesses debts. Unless specific continuation provisions are made in the

agreement, death, bankruptcy or retirement will dissolve the partnership. Less flexibility than a limited company, in transferring ownership. High level of trust required. Whether drawn or not, the profits are taxed as income.

Self-employed national insurance entitlements have less benefits. Tax relief on pension contributions is restricted. Partners can be sued individually, or together by a creditor that has not been paid. However remaining partners must buy out the share of the deceased, bankrupt or retiring partner and it may be difficult to raise the necessary funds. The Business Names Act 1985 requires the names of all the members of a partnership and addresses in Great Britain where documents can be served, must be stated at all business premises so they can be easily read. Also all names must go on letterheads/documents.

If more than 20 partners, the firm may elect to have a statement on letterheads/documents of the firms" principle place of business with indication that the partners" names can be inspected there. Partnership will be in contract if a partner without the relevant authority binds them to it (apparent (ostensible) authority). The partnership is bankrupt if all the partners are also bankrupt (excluding a limited partner under the Limited Partnership Act 1907. There are many factors that are the same for a LTD and a PLC so these will be covered first and then the individual factors will be looked at later.

The company is considered by law as an artificial legal person and has an independent legal and tax status. Therefore it can sue and be sued in its own name. As the company is independent of its members, there is limited

liability for its shareholders who just risk the amounts invested. Unlike a sole trader and a partnership, the company owns the assets. The death or bankruptcy of a member does not affect the company, which has perpetual succession. Also, the members do not go bankrupt if the company is being wound up.

To provide funds for the company shares are issued, which can have different classes and rights (e. g. preference shares and equity shares). Only company directors can bind the company. There is no upper limit restricting the number of members a company can have. A company has a greater facility for borrowing (e. g. it can borrow on debentures) and raisingfinanceexternally. The formalised structures make management clearer. It is easier to widen the ownership base. There are no limits regarding contributions made to a pension scheme with tax relief.

Income tax is only paid on salaries drawn. When profits are retained in the company the higher rates of personal tax can be avoided. It is very time consuming and expensive to set up as a company. There is a complex registration – registering under the Companies Acts, documents must be delivered to the Registrar of Companies and there are many related fees. The companies must conform to the relevant formalities of the Companies Act 1985. There are many requirements concerning factors such as the accounts and records, audits, share issues, directors requirements etc.

The accounts and records must be made accessible to the public so competitors will have access to them. Company subject to regulation and suspension from secretary of state for trade and industry, the courts and the

registrar of companies – certain accounts records to be submitted to ROC – less of confidentiality. Audit and account costs high, full audit costs if sales exceed an upper limit. Shareholders personally taxed on dividends. Double tax when company pays corporation tax on profits and capital gains. Higher national insurance contribution.

Limited liability initially as creditors and banks request personal guarantees from directors. Private Limited Company (LTD company) Has no minimum value required for the allotted share capital. Can on receipt of its certificate of incorporation limited can borrow and commence business. A LTD company needs only one director and one shareholder. There is less legislation than PLC to comply with. A member can appoint only one proxy who can vote and address the meeting. Can provide financial assistance to a person to help them purchase the companies shares.

It is optional for a LTD to pay dividends. A LTD company can not sell shares or debentures to the public. Has to publish accounts but gets partial exemption from publishing the full accounts, if they are bellow an upper limit. The company secretary is not required to be qualified or experienced, so there may be a lack of knowledge. Share holders can not easily sell shares due to the lack of a market and Articles of association restrictions on transfer. The Public Limited Company (PLC company) Raise capital by selling shares and debentures to the public.

Needs 2 directors and 2 share holders (unless registered before 1st Nov 1929). A member can appoint more than 1 proxy who can vote but can not address meetings. The secretary must be qualified and posses the requisite

knowledge and experience. Public scrutiny over accounts aids performance and efficiency. Large market for shares. No restriction on share transfer on stock exchange, USM and AIM but must keep track of who has shares. Encourages investment into company by share ownership by paying dividends. Can be exempt from the statutory requirement to have its year end accounts audited.

Has legal requirement concerning allotted share capital – must be equal or greater than fifty thousand pounds. Can not exercise its borrowing powers or enter business transactions until the registrar has granted it a section 117 certificate. High degree of legislation, rule and formalities it must conform to, e. g. directors retiring at 70 years of age, minimum of 2 directors, voting for directors individually at a general meeting, share allotment. Must publish its accounts in full. Can not give financial assistance to a person to enable him to purchase the companies shares.