Fairhurst

Accounting for your potential

Benefits of being a sole trader versus limited company

Which is best for your circumstances – run your business as a sole trader or incorporate as a limited company? In this article we cover the differences of each option and their advantages and disadvantages.

The first question to ask is if the trade or service you provide involves risk. A sole trader will be held personally liable for outstanding debts if the business fails. It is possible for a sole trader to insure against debts but make sure you read all the small print very carefully. In a limited company the only assets at risk are those owned by the company and your personal assets remain safeguarded.

So, if you believe there is little risk involved what is the next thing to consider? We would assume take home pay would obviously be high on the list.

For a small business with taxable profits up to £20,000 the sole trader route would probably be the better option. Although you may receive tax benefits from being a limited company at this level, these would more than likely be cancelled out by the increased costs involved in running one. However, this advice only applies if you intend to withdraw all your earnings. This all changes again if you intend to retain profits in your business.

Simplicity versus size can also contribute to your decision. Being a sole trader is simpler from a HMRC perspective, only being required to record business expenses and personal income on a self-assessment tax return once a year. There are no set up and formation costs and accountancy fees are generally much lower, but there is less opportunity for tax planning. Limited companies are more costly to set up and also must prepare annual accounts including information about directors and shareholders - requiring much more administration and higher associated costs. However better tax planning opportunities are available.

But further down the line if your business starts to develop and grow the benefits of a limited company come into play. It has its own legal identity and can also look more impressive and credible. Also some larger organisations will only work with other limited companies. Importantly too it can give you greater borrowing power to expand the business and is also advisable if you wish to sell the business in the future.

Obviously there are a lot of things to consider and we would recommend that you speak to an accountant who can advise you which would be your best course of action based on your specific circumstances.

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