



Business Structure



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Having decided to start your own business, it is vital that you choose the best type of business for your needs. Friends, colleagues, accountants will probably all offer differing views on how you should work. So how do you decide?

Freshwater will operate and advise our clients to operate within the law but by all means arrange your affairs so as to reduce your overall tax liabilities.

We are here to provide you with guidance on the choices available to you, however you are free to operate through any business vehicle you may choose.

We are able to assist you with the decision and we can provide a tax efficient solution for you.

The vast majority of our clients choose to operate through their own limited company, other options are given below:

1. Limited Company
2. Umbrella Company
3. Off Shore Company
4. Sole Trader
5. Partnership
6. Limited Liability Partnership

1. Limited Company

Trading through a Limited Company has become increasingly popular due to flexibility, security and tax efficiency.

A Limited Company has a separate legal entity from the owners, even if you own 100% of the shares. The profits and assets of the company belong to it, not you as the shareholder, profits made by the company are withdrawn by dividends to the shareholders or as salary to employees.

Apart from advantages such as limited liability, the main advantage of operating through a limited company is that profits can be extracted by dividends, rather than as salary, because dividends are not subject to National Insurance contributions, the savings can be very beneficial.

Whilst there are other trading options detailed on our website, these rarely prove to be either as tax efficient and/or compliant with tax laws. If you are contemplating starting your own business, these are aspects that you do need to consider.

With the experience and knowledge of freshwater backing you up, we are confident that you will find that the process is more straightforward than it may first appear. freshwater can register a Limited Company for you, this is supplied free of charge to new clients.

Please refer to our separate Limited Company Guide for more details.

Our charge for this service is £85 + VAT per month.

2. Umbrella Company

This is usually a single company with a large number of workers. The advantages of umbrella services may mean reduced paperwork and are an easy option if you only intend to contract for a short period.

Disadvantages of using an umbrella service will include reduced income compared to other methods, net income is often inflated due to abuse of 'HMRC approved expenses schemes' and 'dispensations', indeed, we are aware of one umbrella company that was forced into administration when HMRC discovered such abuse. Your money is also at risk from the umbrella company ceasing to trade (eg, Sunday Solutions, Prosperity 4, Albany.) leaving their freelance contractors out of pocket.

Lastly, there is an increased risk a HMRC investigation, especially if the umbrella company is found to be incorrectly treating expenses etc.

Note that any incorrectly paid expenses will be recovered from the employee and not the umbrella company. The introduction of the Agency Workers Regulations (AWR) in October 2011 will have a major impact on how umbrella companies operate. It is highly likely that they will cease to exist in their current form.

3. Off-Shore Employee Benefit Trusts (EBT)

EBT schemes are heavily promoted by organisations usually based in the Isle of Man, the Channel Islands and even Switzerland. A common boast is that a contractor can retain up to 85-90% of their income.

Although many schemes claim to have unique features, they all essentially work the same way. The contractor will receive a low salary of say £12,000 per annum; this will be subject to UK income tax and national insurance. Please note that the payment of a relatively small sum of tax does not legitimise the scheme! After the retention of a large fee by the scheme provider (usually 10-12% of your income), the remainder of the funds are provided in the form of a loan.

- Usually the tax and national insurance paid on the salary is the only tax that is paid, probably no more than £1,500 per annum. This probably equates to an overall tax rate of no more than 2%!
- If a scheme makes promises that a contractor will retain 85% of their income, the fees paid to the scheme provider will probably be 12% of the contractor's income.
- You will be subject to tax on the loan until it is repaid or written off.
- The scheme provider will promise not to ask for the loan to be repaid, ever. This is clearly a big risk to take on trust alone.
- If the loan is written off, it becomes fully taxable.

HMRC estimate that there are 50,000 contractors using these schemes. Legislation from 6th April 2011 has made these schemes futile, in addition measures have also been introduced to bring the rules into effect for any loan made from 9th December 2010.

Scheme providers will often quote that their scheme is 'QC approved' or 'legally backed' and even 'HMRC approved', none of these will protect a user when HMRC start to investigate. At the end of the day it is the user that is liable to pay the taxes, not the scheme provider or any legal advisors. It is inevitable that the demise of EBT's will continue to grab headlines over the next few years, as old users are forced to pay large tax demands and new schemes are closed down. The legislation is very complex, highlighted by the fact that it takes 59 pages to cover the points. Our view remains that these schemes should be avoided. With proper tax planning it is possible to achieve high income retention, 80% is not unheard of and without the sleepless nights. Freshwater has never offered EBT or any other off-shore schemes.

4. Sole Trader

This is a common, low cost, way of operating a business popular with plumbers, taxi drivers, builders etc. This will entail registering as self-employed with HMRC using a CWF1 form and paying Class 2 National Insurance contributions, usually by direct debit.

Legally, there is no difference between the owner's personal and business affairs, so this should be considered when thinking about taxation and legal liability issues. An important aspect is that the owner is taxed on all the profits, even if some are re-invested in the business.

If this approach is what you choose we will assist with HMRC registration, VAT registration, record keeping. Be aware that even if this method is what you would like, your clients or agency may not be prepared to engage you on this basis. This is because if your self-employed status is challenged they could become liable for any extra tax and NIC liabilities that may be due.

The Income Tax (Earnings and Pensions) Act 2003 Section 44 effectively prevents individuals from trading as sole trader where an agency is involved, as it obliges the agency to treat the individual as if they were an employee and so are required to deduct PAYE and NIC from any payments due.

Please refer to our separate Sole Trader Guide for more details.

5. Partnership

Partnerships as a business model are very similar as a sole trader, except that they are used when more than one person wishes to own the business.

Each partner pays income tax, through the Self Assessment system, as well as Class 2 and Class 4 National Insurance – and the business itself pays VAT if it has registered.

With the Partnership model, each partner has joint liability for the debts of the Partnership, so if one partner cannot pay their share of any debts, the debt will fall on the other partners.

If this approach is what you choose we will assist with registration with HMRC, VAT registration, record keeping. Our charge for this service (2 partners) is £170 + VAT per month, additional partners are charged at £85 + VAT per month.

6. Limited Liability Partnership (LLP)

An LLP is an alternative corporate business vehicle, giving the benefits of limited liability but allowing its members the flexibility of organising their internal structure as a traditional partnership.

An LLP is different from a traditional partnership in that it is a legal entity separate from its members. In many ways it is a partnership in name only. It has "members" rather than partners and must be formally incorporated to exist.

Because an LLP is a legal entity it is subject to some parts of the Companies Act.

Two or more persons are able to incorporate as an LLP in England, Scotland or Wales. It is not possible to convert a company to an LLP or vice versa.

As a member of an LLP, you are self-employed and must register with the HMRC. Members of the LLP take remuneration in the form of drawings, which have no effect on the profits of the LLP declared for income tax purposes; in other words, drawings cannot be deducted from the profit figure to arrive at taxable profits.

If this approach is what you choose we will assist with registration with HMRC, VAT registration, record keeping. Our charge for this service (2 partners) is £170 + VAT per month, additional partners are charged at £85 + VAT per month.

