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Online Accounting Software

COMPANY STRUCTURE GUIDE

Why you need to think about your company structure

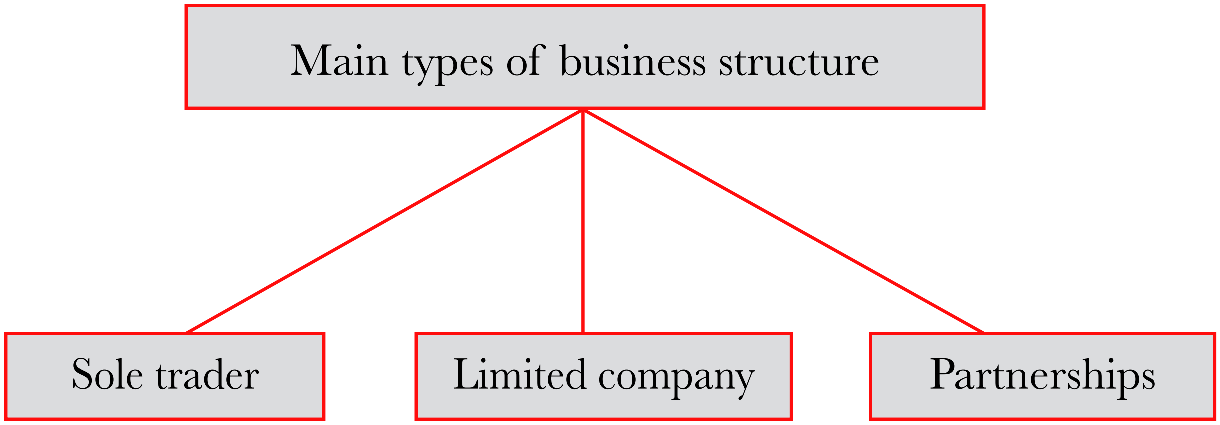
Once you've decided to start your own business, one of the first things you should do is decide what kind of structure it's going to be. You might think this just sounds like lots of 'red tape' or something that you don't have time to think about, so why is it important?

Apart from it being something you must do for all sorts of legal reasons, it's fundamental because there are a number of different business structures and the type you choose will have a big impact on you. In fact, the success of your business really can hinge on it.

The structure of your business will determine what you must do to get started, the taxes you'll have to manage and pay, how you can take the profit your business makes and your personal responsibilities if your business makes a loss or fails.

Main types of business structure

A simple representation of the three types of companies below.



Sole trader

A sole trader is described as self-employed, in other words you work for yourself. You can keep all the profits your business makes – but you have to pay income tax on them.

It's important to understand, however, that being a sole trader doesn't mean you have to work alone – you can still employ other people. The key is that you are solely responsible for the business.

Pros and cons

Being a sole trader is a very simple set-up that requires the least amount of administration. You don't need to register your company or pay corporation tax and as long as you don't employ other people, paperwork and red tape will be minimal. As a sole trader, you're under no obligation to file accounts or have an annual audit. This should not be confused with the sole trader's obligation to file a tax return each year.

However, financial responsibility is in your hands, which includes any bills, losses or debts. You will have to self-assess the amount of tax you pay every year and you also have legal responsibility for the business, so some sort of insurance is a must in case someone makes a claim against the company.

What types of business suit being a sole trader?

Self-employment in Ireland is on the increase again after witnessing a dramatic decrease following the collapse of the construction industry in 2007. Essentially, as the name suggests, this structure suits small or 'one-man-band' companies. Many are based at home but other sole traders include taxi-drivers, hairdressers and carpenters. There are 335,000 people working for themselves in Ireland, which is about 18 per cent of the total workforce.

Limited company

A limited company is a separate entity set up to run a business and is responsible in its own right for everything it does. As a result, it is distinct from its shareholders and directors. Its finances are separate to your personal finances. Profits are owned by the company, and can be paid out after it pays corporation tax.

Every limited company has 'members' – the people or organisations who own it by having shares in the company. However, this doesn't mean you have to share ownership with other people – you can own all the shares in your company yourself. Directors run a limited company but are not always shareholders.

Pros and cons

Limited companies must pay corporation tax on profits, which, depending on your profits, can offer a much more attractive rate than income tax. As a director you can choose to take money out of the company via a salary, dividends (payments made to shareholders only) or a combination of both. Dividends are not subject to national insurance and so can be a real benefit for limited company owners. There are also good tax reasons for taking a small salary.

Getting the best out of the tax rules for limited companies is not straightforward and you will almost certainly need an accountant to help. You won't have to sell your house to pay the company's debts if it fails, but on the downside there's a lot of administration that you are required by law to complete every year, including statutory accounts and providing information to Company Registration Office (the government body that deals with the records for registered companies).

What types of business suit being a limited company?

The range is enormous, covering almost every business sector you can think of. As a general rule of the thumb, once your company grows beyond a certain size, or income level, it's usually time to think about forming a limited company.

This is the structure chosen by 'micro-businesses' of just a handful of people to multinationals employing thousands. According to the Companies Registration Office, Ireland had 161,071 limited companies at the beginning of 2014. However, it's worth noting that 70,000 of those were one-man-band outfits, emphasising that the choice between sole trader and limited company status is not clear-cut.

Partnerships

Partnerships are often similar to a sole trader set-up – only they have more than one owner. However, there are different kinds of partnerships, with different rules of responsibility for the business.

In an 'ordinary' or 'unlimited' partnership, all the partners personally share responsibility for things like losses and the bills. With limited partnerships, responsibility, or liability as it's also called, is unequally shared by its partners. So-called 'general' partners are liable in the normal way but 'limited' partners are only liable up to the amount they initially invest in the business. Finally, in a limited liability partnership, all the partners are only liable to the amount of money they invest in the business.

By the way, it's worth noting that a partner doesn't have to be a person – it can also be a limited company.

Pros and cons

Partnerships are a common extension of the sole trader model, for example, when two individuals or a husband and wife work together to build the business. The partnership is just as flexible, has the benefit of two or more people sharing responsibility and the business won't collapse if one of you is sick or needs a holiday. However, some larger clients may be reluctant to do business with you because you are not incorporated at Company Registration Office, something that lends credibility in the eyes of many potential customers.

Limited and limited liability partnership structures offer more protection from financial peril, plus more flexibility in terms of how profits are allocated to individual members. Furthermore, because individual partners are classed as self-employed, they pay national insurance at a lower rate than if they were employees. All limited and limited liability partnerships must be registered at Company Registration Office – good for business credibility but bad if you hate lots of extra administration.

What types of business suit being a partnership?

Many smaller businesses, like building and domestic services firms, choose the ordinary business partnership structure. Limited or limited liability partnerships are especially suited to professional services companies, like solicitors or accountants. They are also the choice of any business where the owners believe the commercial risk is so high that it's the only option they feel comfortable with.

Business structures for good causes

There are also a number of structures for organisations that are not about making profits for the owners. They include unincorporated associations, set up for voluntary groups or sports clubs, and community interest companies, a special type of limited company which exists to benefit the community.

No hard and fast rule

If you're starting out in business, you need to choose a structure that reflects your financial and tax needs and your attitude to admin. Businesses are so varied that there really is no hard and fast rule for what structure will work and it's likely that as your business grows and your aims change, the most appropriate structure to use could change too. Remember to keep assessing your business as it grows because reviewing your structure could save you money in the long run.

WHO WE ARE

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Our online account's software is simple and easy to use and takes only minutes to set up. It is designed to enable smart business people get on with doing what they do best which is to sell their products or services.

We believe in giving exceptional value by including multiple users, unlimited transactions, telephone, email, live chat support and free access for your accountant and bookkeeper, all for a low monthly fee.

Join over 35,000 businesses that have already made the smart move and get your business up and running with Big Red Cloud's online accounts software.

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