Sole Trader v Limited Company

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Sole Trade vs Limited Company- What's The Difference?

Sole Trader

As a sole trader, you and your business are legally the same entity. You keep all profits but also assume full liability for any debts or losses, meaning personal assets like your home or savings could be at risk. Additionally, a sole trader business cannot have multiple owners.

Limited Company

A limited company, on the other hand, is a separate legal entity. This means your personal assets are protected, and you are only liable for business debts to the extent of your investment. Limited companies also offer flexibility in ownership and can have multiple directors and shareholders.

Key Differences:

- **Liability:** Sole traders have unlimited liability, while limited companies provide limited liability protection.
- **Tax:** Sole traders pay income tax on profits; limited companies pay corporation tax and have tax advantages through dividends and structured income.
- **Complexity:** Limited companies require more paperwork and adherence to regulations.
- **Profit Distribution:** Limited companies can retain profits and distribute dividends, which may offer tax efficiencies.

Pros and Cons of Each Structure

Sole Trader - Pros:

- Keep all profits after tax.
- Simple administration and setup.
- Tax-efficient for lower earnings.
- Losses can offset other income tax liabilities.

Sole Trader - Cons:

- Unlimited personal liability for debts.
- Personal assets at risk.
- Harder to sell or transfer the business.
- Less tax-efficient as income grows beyond £20,000.
- Limited access to certain clients and funding.

Limited Company - Pros:

- Limited liability protects personal assets.
- Easier to sell or transfer ownership.
- Tax advantages via dividends and structured pay.
- Can make company pension contributions to lower tax.
- More attractive to some clients and investors.
- Flexibility with multiple shareholders or directors.

Limited Company - Cons:

- Higher administrative costs and complexities.
- More paperwork and regulatory responsibilities.
- Complex tax and national insurance rules.
- Public disclosure of company information.
- Personal guarantees may be required for business loans.

Do You Need To Register Your Business?

You can earn up to £1,000 tax-free from self-employment annually. Beyond this, you must register as a sole trader or establish a limited company.

How to Register as a Sole Trader:

1. Register for Self-Assessment via GOV.UK by October 5.
2. Submit annual tax returns and keep detailed records.
3. Pay income tax and national insurance.
4. Register for VAT if turnover exceeds £85,000.
5. Use a business name (restrictions apply).

How to Register a Limited Company:

1. Choose a unique name ending in “Limited” or “Ltd.”
2. Appoint directors and shareholders.
3. Create a Memorandum and Articles of Association.
4. Register with Companies House, including for corporation tax.

Switching from Sole Trader to Limited Company

Many start as sole traders and later incorporate. To transition, you must:

1. Register your new limited company.
2. Deregister as a sole trader with HMRC.

Conclusion

Choosing between a sole trader and a limited company depends on liability, tax efficiency, and administrative workload. Consider your business’s financial outlook, your willingness to handle more paperwork, and your future goals. For personalized advice, Finova Accountancy is here to guide you every step of the way. Contact us to discuss the best options for your business journey.