

Forming a business

Before you start trading, you will need to decide on a legal structure for your business, consider the legal implications of what you call your new business and register your new venture with official bodies.

Choosing a legal structure

The type of business structure you choose will depend on your own situation. Since it will affect important aspects of your business – for example, the amount of tax you pay on your business activities - it's a good idea to get advice from your Prince's Trust contact, business adviser or accountant before making a final decision.

The three most common legal structures for businesses are:

- **sole trader**
- **partnership**
- **limited company**

Sole trader

This is the most common way of starting a business and is probably the best option for most young entrepreneurs. As a sole trader:

- you will have overall control of your business.
- you'll be responsible for any debts the business runs up.
- you will be regarded as self-employed for tax purposes. This means you must pay income tax and **National Insurance contributions** through HM Revenue and Customs' (HMRC) self-assessment system.
- you don't need to register accounts or have your business accounts audited. But you'll still need to keep detailed records of all transactions for your annual tax self-assessment.

National Insurance contributions: made if you are an employee or self-employed to build up entitlements to a State Pension and other social security benefits

Pluses	Minuses
<ul style="list-style-type: none"> → You need to register your business with HMRC within three months of starting-up. There's no cost involved in registering. → Trading is very straightforward – you simply take your business's profits as your income and pay tax on this. → National Insurance contribution levels are generally lower than those for limited companies. → This structure has the least amount of paperwork. 	<ul style="list-style-type: none"> → You are responsible for any money your business owes, such as bank loans for your business's debts. This means you'll have unlimited liability. → If your business fails, your own assets (like your home, car or savings) could be at risk. → The amount of money available to sole traders from banks and investors can be limited. → Some customers and suppliers prefer to deal with limited companies.

Partnership

This legal status is used when two or more people want to set up a business together. Like a sole trader, it's easy to register and doesn't involve huge amounts of paperwork. In a partnership:

- you can have up to 20 partners.
- the profits from your business will be divided between these partners.
- you will be classed as self-employed for tax purposes and have to pay income tax and National Insurance contributions through the self-assessment system.
- you'll be responsible for any debts the business runs up. This responsibility is shared between all the partners.

Before starting a business with other people, it's a good idea to draw up a **deed of partnership**. If you don't do this, any disagreements will be ruled by standard laws, which don't take into account your individual circumstances.

Deed of partnership: a legal agreement drawn up between the partners of a business

Pluses	Minuses
<ul style="list-style-type: none"> → The way you set up the partnership can be flexible and you can set out these arrangements in a deed of partnership. → The responsibilities, risks and losses are shared between several people. → Partners bring a variety of different skills and experience to the business. → Because more people are involved, you may have access to more money to invest in the business. → There is less paperwork to deal with compared to a limited company. 	<ul style="list-style-type: none"> → Like a sole trader, without a separate legal identity the partnership has unlimited liability. This means each partner is personally responsible for the debts of the partnership. → All the partners can be held responsible for any one partner's negligence. This is important because each partner can make a binding contract without the permission of the others. → Problems can occur when there are disagreements between partners.

Limited company

The main advantage of setting up as a private limited company is that you are not personally responsible for the company's debts. But this legal structure is more complex and involves more paperwork and costs. If you're starting a high-risk business that needs a large amount of **capital** from the start, this option will probably be the best.

In a limited company:

- the company is viewed as a legal entity completely separate from yourself, unlike a sole trader or partnership.
- there must be at least one **shareholder**, at least one **director** and a company secretary.
- you can have up to 50 shareholders in the company and the liability of each is limited to the value of their shares.
- the company will be subject to corporation tax on its total profits – including capital gains – for an accounting period. This is different to sole traders or partnerships which pay income tax on their profits.
- the company will need to collect and pay income tax and National Insurance contributions from their employees through a PAYE (Pay As You Earn) system.
- you have to prepare, maintain and submit accounts to Companies House each year. This includes a profit and loss account and a balance sheet.

Capital: money or other assets brought into a business

Shareholder: someone who owns one or more shares in a company

Director: a member of the board, involved in controlling or directing business development or finances

Pluses	Minuses
<ul style="list-style-type: none">→ Your responsibility for debts is limited to the initial cost of your shares.→ Money can be raised by selling shares in the business.→ Employees can own a share of the business.→ A limited company has a legal identity separate from that of its owner(s) – this allows the company to continue trading even if a member resigns or dies.→ The name of the company is protected by law.→ Some suppliers and customers think that limited companies are more credible than other types of businesses, which could be a competitive advantage.	<ul style="list-style-type: none">→ A company must comply with a wide range of complex and detailed legislation which does not apply to sole traders or partnerships. This can add to the administrative and financial burden of running a company.→ Public disclosure of the company's accounts means that anyone can find out how well or badly your company is doing.→ You will often need to give personal guarantees to get bank loans.

Choosing a name

Picking a name for your business is more complicated than simply thinking one up and using it. There are regulations which can limit your choice, depending on whether you run your business as a sole trader, partnership or limited company.

Whatever type of status you choose, your business name can't:

- already be used by another business
- breach a registered **trademark**
- be offensive
- use words restricted by the Government – you can find a full list of these on Companies House's website www.companieshouse.gov.uk

Trademark: a legally protected mark or symbol that cannot be copied

If you operate as a sole trader or partnership you don't have to register your business name. If you set up a limited company you must register your business name with Companies House.

If you choose to run a business using a name that is not your own you must display the trading name, the individual owner's name or the name of each partner and the business address on:

- your place of business (where you deal with customers and suppliers)
- business letters
- written orders for goods and services
- written demands for payment of business debts

Once you have decided on a business name, you may want to design a **logo** for your business. This can convey who you are and what you do in a simple, imaginative and memorable way. Effective logos are:

Logo: a combination of characters or graphics that distinguish one business from another

- unique enough to create a memorable and lasting impression
- simple enough for people to remember easily
- imaginative enough to be different from your competitors
- clear enough to be reproduced to any size and scale – from a business card to a shop sign

Your logo shouldn't:

- be in use by another business or be very similar to that of another business
- conflict with an existing registered trademark
- be offensive
- mislead the public
- constitute a criminal offence. Some designs are protected by law (for example, badges relating to government, national or international institutions such as the Olympic Rings)

If you want to use your logo as a trademark you must register it at the Patent Office - you can find more information by visiting www.patent.gov.uk.

Who do you need to tell?

As a sole trader or partner in a partnership, you must contact your local HMRC office – www.hmrc.gov.uk – to register as self-employed, within the first three months of trading. You could incur a penalty if you don't register during this time.





A limited company must register with Companies House before it starts trading. Several documents (the articles of association, form 10 and form 12) must be completed and submitted along with a small registration fee. An accountant or solicitor can help you to draw up and submit these documents. A limited company must also submit a set of accounts to Companies House within 10 months of the end of the first financial year. There are automatic fines for accounts that are filed late.

VAT: sales tax charged on certain goods and services

If you expect your turnover to exceed the threshold for **Value Added Tax (VAT)** - £60,000 in 2005/6 - then you must register with HMRC. You'll need to check with HMRC what the VAT threshold is each

tax year as it can change from year to year.

Tasks and tips

-  Ask your Prince's Trust contact, business adviser, accountant or solicitor for advice on which form of legal status is the best for your business – and the tax implications. The Trust also has a free legal helpline available to businesses it currently supports which can help with legal queries. Ask your Prince's Trust contact for the reference code and telephone number.
-  Get your tax situation sorted. HMRC produces various useful leaflets – use these to plan how much tax you will need to pay, and when. Then put that money aside before it gets used to meet other expenses.
-  When choosing a name for your business, keep it simple. Shorter names are easier to remember.
-  If you are setting up a limited company, it is possible to buy existing or 'off-the-shelf' companies via a Company Registration Agent, accountant or solicitor. All the paperwork will have already been prepared and the company can begin trading almost immediately.

Many of our loans benefit from a guarantee provided by the European Investment Fund under the European Community's Multiannual Programme for small and medium sized enterprises.



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