

Seek advice before deciding between limited company and sole trader status

HSBC Bank has found that a third of Britain's four million small businesses have changed their legal structure since they were formed, to take advantage of reduced financial risk and lower tax rates for limited companies. But because the 2004 Budget made becoming a limited company less attractive, HSBC says small firms should review their legal status and seek specialist help to ensure they are still best placed for future growth.

A survey of 7,000 UK small businesses revealed that of the companies that changed their legal status, over three-quarters (79 per cent) switched from sole trader or partnership to limited company status.

Reducing financial risk was far and away the most important reason for changing, rated highest priority for a third (34.5 per cent) of firms. However nearly a fifth (19.8 per cent) said that they changed following professional advice and more than one in ten (11.2 per cent) were looking to benefit from a lower tax rate.

One of the financial benefits of becoming a limited company in recent years was a tax loophole enabling small companies to pay out their profits as dividends with a zero effective tax rate for both companies and their shareholders. But this was removed from 1 April 2004, when the Chancellor introduced rules that meant a minimum of 19 per cent corporation tax would be charged when dividends were paid to non-corporate shareholders.

Other reasons business owners cited for changing legal identity ranged from simplicity (7.6 per cent), flexibility (5.1 per cent), expanding their business (4.1 per cent), to reducing their administration burden (2.2 per cent) and raising capital (1.9 per cent).

"Setting up a company gives your business protection, rights and tax advantages, but along with the advantages come extra duties, such as filing formal accounts for public inspection," says Simon Wainwright, HSBC's head of small businesses.

"We know that many sole traders and partnerships incorporated to take advantage of the zero per cent corporation tax rate introduced in 1992. However the decision to tax the distributed profits of incorporated companies at 19 per cent in the 2004 Budget has reduced the appeal of incorporation. Small businesses should seek professional advice to ensure that their current choice of legal status is best for their needs."