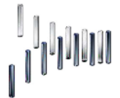

INTEGER WEALTH GLOBAL

Literature – Limited Company versus LLP (Limited Liability Partnership)

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Limited companies and LLPs share many similarities, most notably the reduced financial responsibility of the owners. However, they do have significant differences as well, namely:

- Capital investment opportunities.
- Flexibility of internal structure and members' rights.
- The allocation and taxation of business profits.

Choosing the most appropriate legal structure will depend entirely upon the kind of business you currently have, or plan to have in the future.

A company limited by shares is the most popular choice for profit making businesses. A company limited by guarantee is the best option for non-profit organisations. A limited company structure is also best if you plan to employ lots of people and/or you want the option of selling shares in your business to raise capital investment. It is also a more tax-efficient structure for many types of businesses.

The LLP format was introduced in 2001 by the LLP Act 2000 to meet the needs of certain professionals who usually form traditional partnerships, such as solicitors, doctors, accountants and architects.

LLPs provide the same benefits as traditional partnerships with the added advantage of reduced financial responsibility for the partners. An LLP structure is a good choice for businesses with minimal employees (if any) and only a few partners, each of whom makes similar contributions to the business, enjoys equal rights and responsibilities, and takes a similar share of business profits.

The main differences between a limited company and an LLP

1. A limited company can be registered, owned and managed by just one individual – a sole person can act as both the director and shareholder (or guarantor). A minimum of two members are required to set up an LLP. However, one way around this is to set up a dormant limited company as the second LLP member.
2. The liability of company shareholders or guarantors is limited to the amount paid or unpaid on their shares, or the amount of their guarantees. The liability of LLP members is limited to the amount each member guarantees to pay if the business runs into financial difficulty or is wound up.
3. A limited company can receive loans and capital investment from outside investors. An LLP can only receive loan capital. It cannot offer equity shares in the business to non-LLP members.
4. Limited companies pay corporation tax and Capital Gains Tax on all taxable income. LLP members pay Income Tax, National Insurance and CGT on all taxable income. The LLP itself has no tax liability.
5. It is easier to change the internal management structure and distribution of profits in an LLP.
6. A limited company can be operated as a non-profit business. An LLP must be set up with the intention of making a profit.

Different tax liabilities of LLPs and limited companies

Limited company tax liability

All taxable income generated by a limited company is subject to corporation tax of 19%. Any salary a director receives will be liable for Income Tax, National Insurance and employers' NI. However, directors are often also shareholders. This means they are treated as employees of their own company. The distribution of profits to directors can be done is such a way that much of the money they receive is not subject to corporation tax or personal Income Tax.

By paying a director a salary of no more than his/her tax-free Personal Allowance, and distributing additional profits by way of shareholder dividends, a director can legally minimise his/her personal tax liability. Dividends are paid from post-tax profits and the first £5,000 of payments are tax free. Additional dividend income is taxed at according to the tax bracket of the recipient.

LLP tax liability

LLP members are treated as self-employed individuals. They have to register for Self Assessment and pay Income Tax and National Insurance on their individual profits, regardless of whether they take all of the profits as a salary or leave some of it in the business. However, they are not liable for Employers' National Insurance on their income.

Depending on the amount of profit generated, the tax liability of LLP members can be rather high. If an LLP member's income exceeds the Personal tax-free Allowance threshold (£11,500 for 2017-18 tax year), he or she will be subject to the following Income Tax rates:

- 20% on taxable income up to £33,500 (you will start paying this rate on income above the £11,500 Personal Allowance threshold).
- 40% on taxable income between £33,501 – £150,000 (you will start paying this rate on income over £43,000).
- 45% on income over £150,000.

Tax efficiency – leaving money in the business

In instances where you will make more annual profit than you need to take out of your business, a limited company will be more tax efficient. There is no need to withdraw all surplus income immediately. Instead, you could leave some of the profits in the business and defer tax by withdrawing the surplus in a future tax year.

This is not possible with an LLP. Regardless of whether the members take all of their annual profit entitlement or leave some in the business, all profit is subject to Income Tax in the financial year it is generated.

Internal structure and allocation of profits

An LLP can offer greater flexibility than a limited company in terms of altering the rights, duties and profit entitlement of individual members. Such arrangements can be agreed verbally amongst LLP members, and they can be quickly and easily changed at any time. However, it is commonplace to draw up an LLP Agreement.

This document will outline the internal management structure of the business and the various arrangements in place, thus avoiding internal conflict and disputes.

The voting rights and profit entitlement of shareholders are governed by the prescribed particulars attached to their shares. In most instances, companies will issue just one type of share, thus providing equal rights and profit entitlement to all shareholders.

It is more difficult to change the rights and profit entitlement of shareholders because they are stipulated in these prescribed particulars. Most companies will draw up a shareholders' agreement to outline their rights, responsibilities and duties, and the way in which the company should operate.