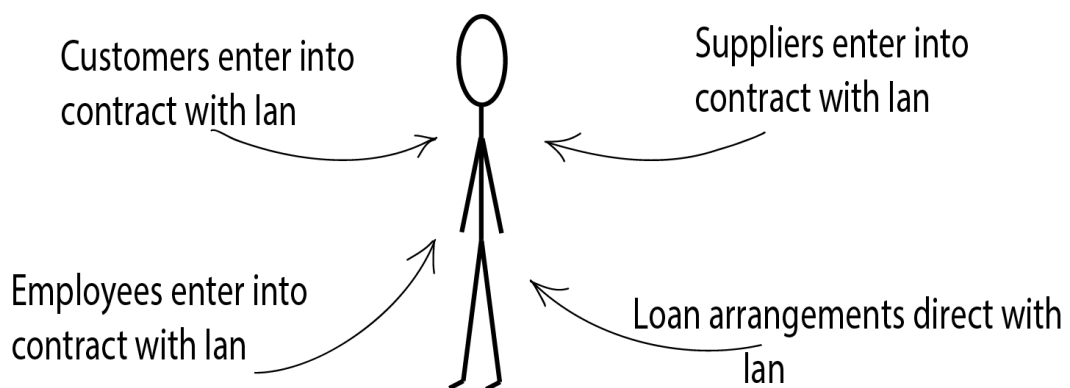


**The content of the Guide is for basic information purposes only and should not be taken to be legal or accountancy advice. It is recommended that you seek specific legal and/or accountancy advice from a specialist to ensure that your precise requirements are met. Efforts have been made to ensure that the information is correct at the time of writing but no guarantee is given in this regard and no liability can be accepted for any losses sustained in consequence of errors.**

### **Guide 3 - Sole Trader**

Ian Brown - sole trader - unlimited liability i.e. both personal and business assets available to customers or creditors if they make claim against the sole trader business

Figure 3.1



#### **3.1 An Introduction to Ian, Sandra and David**

A scenario is used throughout the Guide chapters to assist with illustrating various points. This business scenario involves Mr Ian Brown who is thinking of setting up a business. Imagine that Ian Brown works as an employee for, say, a pie manufacturer. His workplace factory is based in a town called Exvill. Ian is an administrator and he has always had an interest in food. Ian decides to set up his own business, selling organic food.

He plans to buy organic food produce from local farmers and wholesalers. He has identified a small industrial unit, on a local farm, from which he could run his business (more on commercial property matters in Guide 11). He wants members of the public to visit the farm shop to buy food. He is also considering setting up a website to allow members of the public (and businesses) to order pre-packed boxes of organic fruit and vegetables for home delivery. He will probably need to employ 2 or 3 members of staff.

Ian has a colleague, Sandra Green, who is currently a co-employee at the factory. She is employed in the marketing department. Another colleague, also an employee

at the factory, is David Pinkerton. David works on the production line at the factory. Ian might ask Sandra and David to start a business with him.

“Which business vehicle should Ian use; should he set up as a sole trader, partnership, company or Limited Liability Partnership?”

### 3.2 Sole Trader Basics

If Ian intends teaming up with others, who will also be owners of the business then he cannot set up as a sole trader. It is only possible to set up as a sole trader if there is to only one owner. If Ian is going to go it alone in business then he need not consider the options of partnership and Limited Liability Partnership; as those two options require two or more people to set up in business together.

If Ian would like to go it alone, in so much as he would like to be the only owner of the business, then he has the option of (a) sole trader or (b) he could consider setting up a private company.

It is possible, in the case of a private company, to have just one owner (shareholder) and one manager (director); and there is nothing to stop a person being both at the same time. Essentially the shareholders (who are also sometimes referred to as members) are the owners of a company. The director(s) are the managers.

The fact that Ian intends to engage two or three employees is irrelevant when it comes to the question as to whether or not he can set up as a sole trader. He can still set up as a sole trader with as many employees as he likes. That is because employees will not be the owners of the business. In a sole trader scenario, there must only be one owner of the business. When it comes to the question of whether the business is a sole trader (sole proprietorship) business or not it is irrelevant how many employees that sole trader employs in the business.

Imagine (for the purposes of dealing with sole trader matters) that Ian decides not to ask Sandra Green or David Pinkerton to join him as co-owners and, instead, he decides to “go it alone”. He could set up a private company (more of that in Guide 5) but, for the moment, imagine that he wants to know more about how to start up a business as a sole trader.

What are the **specific legal issues** that Ian must consider when setting up as a sole trader?

The reference to “**specific legal issues**” is not to those legal issues that are common to most types of businesses (whether they be sole trader, partnership, private company or LLP) such as drafting contracts, engaging employees, buying the business premises, protecting Intellectual Property Rights etc. Instead “specific legal issues” is a reference to those specific legal issues that are involved in the setting up of the specific business vehicle in question.

All of the other matters – involving contract law, employment law, Intellectual Property law, tax law, regulatory law and so on, will be dealt with in later Guides. For the next few Guides (Guides 3 to 6) the emphasis will just be on the specific legal

issues involved in setting up the business vehicles themselves and not on the associated matters of employment law, contract law, Intellectual Property, commercial property law, regulatory law etc.

So, what **specific legal issues** are relevant to the process of setting up the business vehicle itself (sole trader)?

### 3.3 Formalities of Setting up as a Sole Trader

In reality, for a sole trader, there is very little to consider, in terms of specific formalities, when it comes to setting up a business. This can be advantageous in terms of saving time and costs; certainly, when compared to other business vehicles, such as a private company or a Limited Liability Partnership.

If, say, Ian wanted to set up a company the law requires him to have a set of formal company rules (known as the Articles of Association – more detail on that in Guide 5) and a Memorandum of Association, and in addition to that he would need to submit application documents to Companies House (more of that in Guide 5 too). Similarly, for a Limited Liability Partnership he would need to submit documentation to Companies House (see Guide 6).

If Ian wants to set up as a sole trader then he does not need to submit any formal start-up documentation to any government body.

It might seem strange that **Limited Liability Partnerships** are required to submit documentation to **Companies House**, given that a Limited Liability Partnership is not a company. However, as mentioned in Guide 2, Companies House has information on both companies and Limited Liability Partnerships.

So, ignoring the paperwork that might be required for contracts, tax matters such as registering the business with HM Revenue and Customs, Intellectual Property matters etc. an individual has no formal process that must be gone through in order to set up as a sole trader.

Another advantage of being a sole trader is that Ian Brown will be the owner and manager of the business. When it comes to making decisions as to how the sole trader's business should be managed those decisions are fully under his control. There would be no need to refer to any other people in order to make decisions.

Compare this with a partnership or with a Limited Liability Partnership, in which the owners (partners being the owners in a partnership and the members being the owners in an LLP) would be required to make decisions or indeed with the situation for a private company in which certain matters will need to be considered and voted on by the shareholder(s) (see Guide 15 for details on decision-making processes in a company).

As a sole trader, Ian would be the sole owner of the business and effectively he would be the sole manager and he would not need a specific agreement detailing precisely how he is expected to run the business. Instead, it is entirely up to him as to how the business is managed.

### 3.4 Business Name Formalities for a Sole Trader

So, are there any **specific legal issues** to consider when it comes to setting up a sole trader business “vehicle”.

There is one, and that specific legal issue concerns how to deal with the trading name of the business and the associated disclosure requirements that might arise in consequence of using a particular trading name. As mentioned later, the rules that apply to a sole trader’s trading name are very similar to those that apply to other business vehicles such as a partnership, private company and Limited Liability Partnership.

What is a “trading name”? Consider a company that is registered at Companies House under the name of, say, Toptoystoday Ltd. You can trade using a different name to your registered name. This is known as a ‘business name’. These business names must not include ‘limited’, ‘Ltd’, ‘limited liability partnership’, ‘LLP’, ‘public limited company’ or ‘plc’.

When a business trades under a name that is different to the actual company name the law says that the business entity must follow specific rules as to what information must be disclosed to the public about the business entity itself. I will refer to these rules as disclosure rules.

**Tip: Disclosure rules are only relevant if the business is trading under a name that is not the same as the name of the individual(s) or the company or LLP.**

Aside from the disclosure rules there are also additional rules and restrictions as to which specific words can or can’t be used within the business name itself.

When it comes to Ian Brown, and his setting up as a sole trader, he will need to consider the implications of the business names rules.

If he chooses to use a business trading name which does not consist solely of his surname (or his surname plus “permitted additions”; permitted additions to a surname will include his initials and forename(s)) then he will be obliged to make certain disclosures on various business documents (documents such as letters, written orders for goods or services that are supplied to the business, invoices and receipts and written demands for payment of debts arising in the course of his business). The law says that if he is trading under a name that is different to his actual name (surname plus permitted additions) then the disclosures that he will have to make will be his full name (plus an address at which service of any document, relating in any way to the business, will be effective) on those various documents.

Additionally, if his business name is anything other than his surname (plus any additions that are permitted) then he will also be obliged to display, in a prominent position at his business premises, a notice stating his actual name and an address at which service of any document relating in any way to the business will be effective.

**Tip: If Ian Brown decides to trade under the name of, say, “I.Brown” or “Ian Brown” then he will not need to disclose his full name and address on (a) business letters (b) written orders for goods or services to be supplied to the business (c) invoices and receipts issued in the course of business (d) written demands for payment of debts arising in the course of the business.**

**Tip: If Ian decides to trade under the trading name of, say, “Yummymunchie” then he will need to disclose his full name on invoices, business letters, written orders for goods or services to be supplied to the business, invoices and receipts issued in the course of the business and written demands for payment of debts arising in the course of the business.**

**Additionally, in the event that Ian trades under the name of “Yummymunchie” and, say, is granted a lease of a farm unit, then he would be obliged to display his full name (and the address of the business) in a prominent position which could easily be read by customers or suppliers at that place of business.**

**Tip: In summary, if Ian is trading under his own name, and not “hiding” behind a trading name, then there is no need for him to make disclosures on letters etc. nor on a notice at his trading premises.**

It is interesting to look in shops to see. When next in a shop look to see whether or not the business is displaying their full name and service address by way of a notice that is prominently displayed in the shop; unless that is the trading name of the business is the same as the sole trader’s actual name e.g. surname only or surname plus “permitted additions”.

The detailed rules of disclosure can be found in the **Companies Act Part 41** (section 1192). It might seem odd that rules relating to individuals (sole traders) and their trading names, and that have nothing to do with companies, is found in the Companies Act 2006, but that is where the rules are.

In addition to the disclosure rules, section 1193 of the Companies Act 2006 says that:

“A person must not, without the approval of the Secretary of State, carry on business in the United Kingdom under a name that would be likely to **give the impression that the business is connected with Her Majesty’s Government**, any part of the Scottish administration, the Welsh assembly government or Her Majesty’s government in Northern Ireland, any local authority or any public authority specified for the purpose of this section by regulations made by the Secretary of State.”

**Tip: If Ian decides to trade under a name which gives the impression that he has a connection with, say, HM Government or with a local authority or any public authority e.g. “Ian’s Food Government Approved”, aside from complying with the disclosure rules he would also need to seek the permission of the “Secretary of State” at the Department for and Trade before he could use that name. That is because “Government” clearly gives the impression that the business has a connection with the government.**

The Company, Limited Liability Partnership and Business (Names and Trading Disclosures) Regulations 2015 specifies the public authorities that would need to be contacted.

The process that would have to be gone through to seek the permission from the Secretary of State does not require Ian to specifically speak to the Minister at the Department for Business and Trade. Instead, Ian Brown would need to contact the department at the ministry that specifically deals with business names to ask for permission.

Another set of rules that Ian would need to consider, in regard to a trading name, are those laid down in the statutory instrument - Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2014.

### **3.5 Acts of Parliament, Statutory Instruments, Regulations and Directives and the Common Law**

As you know it is the United Kingdom Government that lays down specific rules for the UK (not forgetting that there are some powers that have been given to the national Parliament in Scotland, the National Assembly in Wales and to the Northern Ireland Assembly).

The UK Government lays down legal rules in one of 2 forms:

(1) Primary legislation – An “Act of Parliament” creates a new law or changes an existing law. An Act is approved by both the House of Commons and the House of Lords and is agreed to by the monarch. Once implemented, an Act becomes law and it applies to the UK as a whole or to specific areas of the country.

(2) Secondary legislation (or delegated legislation) allows laws to be put in place without a new Act of Parliament. A Statutory Instrument (SI) is technically a secondary piece of legislation. Statutory instruments, as well as being given names, are described by the year of issue along with a number; in the case of the Statutory Instrument that deals with sensitive words, the number being 2014/3140. You can use this number to find specific Statutory Instruments by going to <http://www.legislation.gov.uk> and searching against “All Secondary Legislation” from the drop-down list and typing in the year and number.

Common Law is the law that comes from judgments handed down by judges in law courts.

**Tip: You can find legislation at <http://www.legislation.gov.uk> There are many Acts of Parliament and Statutory Instruments (SIs) mentioned in this Guide so do use this free facility if you want to check out any of the specific sections of those Acts or SIs that are mentioned throughout this Guide. Common law cases can be found on specialist provider sites such as Westlaw but these are not free to access. Instead you could use an internet search engine which will sometimes come up with the full text of a case or a summary such as the British and Irish Legal Information Institute. (<https://www.bailii.org/>)**

Returning to the Statutory Instrument that is The Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2014 (Statutory Instrument 2014/3140). This set of rules essentially prevent a sole trader (and other businesses too) from using certain words in a trading name which are deemed to be “sensitive” unless, that is, the business obtains prior approval from specified government departments and bodies. For example, words such as “Society”, “Patent”, “Police”, “Prince”, “British” would need consent from a specified government department. Police, for example, would need approval from the Home Office.

**Tip: Say Ian decides that he wants to use the word “Royal” in his business name e.g. “Royal Yummymunchie Foods” (and for the purpose of this illustration we will say that his business is being run in England) then Ian would need to seek the consent of the Ministry of Justice, before he could use the word “Royal” in his trading name. If his business was being run in Wales then Ian would need the consent of The Welsh Assembly Government and if in Scotland he would need the consent of the Scottish Government.**

Although there are some twists and turns to the rules relating to the names that a business may trade under there are no other specific legal issues for a start-up of a sole trader business. Of course, as mentioned earlier, there will be plenty of general legal issues that will need to be dealt with, such as liaising with HM Revenue and Customs, drafting contracts, dealing with employee matters and so on (general matters) but in terms of the basic start up procedures for a sole trader (ignoring the general matters) there is little that is formally required to be done in order to start a business as a sole trader; other than dealing with trading name issues.

### **3.6 Setting up as a Sole Trader – Advantages**

The fact that starting as a sole trader is very easy to do is definitely an advantage that Ian Brown might find very appealing. As mentioned earlier, he might like the fact that there aren’t numerous rules as to how his business should be run (compare that with the many rules and regulations that apply to companies and Limited Liability Partnerships; for more of which see Guides 5 and 6) because he will have a great deal of flexibility in terms of how he can go about managing his business.

There is of course no one that Ian is obliged to discuss management issues with, in terms of day-to-day decision-making, and so a sole trader does have the advantage that the individual is very much in control. Additionally, if the business does make any profits then all of the profits belong to Ian as the sole trader and he does not have to split those profits with other owners.

As a sole trader Ian will be responsible for submitting his business accounts to HM Revenue and Customs (but he might engage an accountant to deal with this – for more on accounts see Guides 7 and 8). As a sole trader he does not have to reveal accounting and other information to the public, so Ian could keep this information out of the public domain. (Partnerships do not have to make information publicly available either).

Compare this with the situation that results if Ian decides to set up as a private company or as a Limited Liability Partnership; in that both companies and Limited Liability Partnerships are required to submit yearly accounts to Companies House along with other documentation, such as a Confirmation Statement. The Confirmation Statement details, amongst other things, who the owners of the company are and who the company officers are (directors and company secretary (if there is one)). Note that a private company does not have to appoint a company secretary. These matters will be looked at more closely in the Guides on companies and Limited Liability Partnerships.

I have referred to “partnership” and “Limited Liability Partnership” several times. There is a distinct difference between a “partnership” and a “Limited Liability Partnership” – more of this in Guides 4 and 6.

### 3.7 Setting Up as a Sole trader - Disadvantages

Having looked at some of the advantages of setting up as a sole trader there now follows some disadvantages to being a sole trader?

A substantial disadvantage for Ian is that, as a sole trader, he has “unlimited liability”. If something were to go wrong with the business and, say, a customer or creditor consequently sued the business (assuming that Ian had insufficient insurance to cover the claim – more about insurance in the Guide on “Regulatory Matters” - Guide 10) then the customer (assuming the claim was successful!) could seek to enforce the claim against Ian’s personal assets as well as against his business assets.

That is a downside for Ian when trading as a sole trader, as compared to say a private company. His personal assets (such as his house, if he owns one) could be “up for grabs” by anyone wishing to make a claim against him as a sole trader (assuming that the claim is successful).

**Tip: A business owner should ensure that they have sufficient insurance in place to cover claims that might be made against the business. This is important for all businesses but even more so for sole traders and partners in a partnership; as sole traders and partners in a partnership have unlimited liability.**

The “*limited*” in “private limited company” refers to the fact that an individual shareholder (owner) of a company, in the event of a successful claim being made against the company, is only required to contribute a sum equal to the value of the share at the time of purchase i.e. the shareholder’s requirement to contribute is **limited** to the value of the share. In other words if Ian was to buy one share in a company and that share was valued at £5 at the time of purchase, and Ian paid £5 to the company at the time of the share being issued to him, then in the event of there being a claim against the company (and there being insufficient insurance to cover the claim) the claimant cannot force Ian, as a shareholder, to contribute any more than the £5 that he has already paid. I will talk more about this when considering companies in Guide 5.



Note, though, that banks and building societies, which lend to companies, will often ask the shareholders or shareholder/directors to act as personal guarantors for any loan made to the company. Similarly, a bank or building society may require the owners of an LLP (members) to act as personal guarantors. Effectively, acting as a personal guarantor overrides the benefit of the limited liability that a shareholder in a company or a member in a Limited Liability Partnership has. For more on this see Guides 5 and 6.

**Tip: Having limited liability does not mean it is unnecessary to get insurance if the business vehicle is a company. It is important to have insurance in place irrespective of what type of business vehicle is in operation. If no insurance is in place then the business would have to pay whatever is owed to the claimant, should a successful claim be made against the business. Even if insured against specific events it is worth checking and getting written confirmation. Covid issues have illustrated the problems that businesses have with insurance that does not cover events that they thought were covered.**

**Tip: Employer's Liability insurance is compulsory for businesses with employees.**

Another possible disadvantage of being a sole trader is the potential perception that a sole trader has less gravitas, when compared to, say, a company. Some people view the extra rules and regulations, that apply to a company, as a good thing and the sole trader, being less regulated than a company, might be seen as potentially less "safe" to deal with.

When banks lend money to companies and to Limited Liability Partnerships it is possible for the lender to take security by way of a charge (mortgage) over all of the assets of the company including, for example, stock and equipment. (As mentioned previously security is a means by which a lender, such as a bank or building society (or any other lender), formally registers its interest against assets e.g. in the case of land its interest is registered at HM Land Registry). In the event of a business becoming insolvent lenders with security against assets will be at the top of the pile of creditors, when it comes to distributing what is left of the assets of the failed business.

It is technically more difficult for a sole trader to raise finance from a lender as lenders (such as banks and building societies) can only register charges against a sole trader's fixed assets, (fixed assets being assets such as the premises (land and buildings)) and not against other assets such as stock (goods) etc.

Contrast that with an LLP or a company raising finance, by way of a loan from a lender, in that the lender **can** take security (registering the bank's interest by way of charge/mortgage) over the stock/goodwill etc. as well as against land and buildings. As a lender cannot register mortgages/charges against stock in the case of a sole trader or a partnership this might be a reason why a bank might be less inclined to lend to a sole trader or partnership, as compared to a company or LLP.

When it comes to the question of tax and comparing a sole trader with, say, a private company or other business vehicles it is best to get advice from a financial adviser; to work out which business vehicle is the most tax efficient for you.

**Tip: When considering which business vehicle to use get advice from an accountant to see which is the most beneficial in tax terms.**

Some of the issues that your accountant will consider include the following:

(a) 2022/23 Corporation tax rates were 19% for **companies**. In the March 21 budget it was announced that in 2023 the rate of corporation tax paid on company profits will increase to 25% (and this happened on 1 April 2023). However, for those with profits of £50,000 or less a small profits rate is in place at the current rate of 19% with a taper above £250,000 so that only companies with profits of above £250,000 are taxed at the full 25% rate. Companies with profits between £50,000 and £250,000 will pay tax at the main rate reduced by a marginal relief which effectively provides a gradual increase in the effective rate of corporation tax. The marginal relief rate fraction is  $\frac{3}{200}$  so that if, say, company profits are £100,000 then the calculation for corporation tax purposes is  $\frac{3}{200} \times (\text{£}250,000 - \text{£}100,000)$  ie £150,000) which equals £2,250. This is the amount that is deducted from the figure that is 25% of £100,000 which is £25,000. As such corporation tax would be £25,000 - £2,250 = £22,750. The effective tax rate is 22.75%. However, note that the calculation will be more complicated than that for the first year to 31 March 2024 because for days prior to 1 April 2023 the previous main tax rate of 19% would apply. To work out precisely how much corporation tax relief a company is entitled to you can use the Corporation Tax Marginal Relief Calculator which can be found on the gov.uk website at <https://www.tax.service.gov.uk/marginal-relief-calculator>

For **individuals** (i.e. which would apply to Ian as an individual sole trader) income tax rates can be 20%, 40% or even 45%; depending on the level of profit that Ian's business makes. A company, unlike an individual, does not benefit from a personal allowance (the standard personal allowance is £12,570 in 2023/24). The higher rate threshold is £50,270. A personal allowance is the amount of income below which individuals do not have to pay any income tax.

Although tax rates, on the face of it, can be lower (say, when compared to the rates for a higher rate tax payer, at 45%) for a company, this will only be of potential benefit if it re-invests all of its profits. If a company does not re-invest all of the profits then it needs to be borne in mind that there is a second layer of tax which can apply when the managers (directors) or shareholders (owners) take profits out of the company.

When the owners of the company (shareholders) take profits out of the company they might do this by way of dividend payments. At the discretion of the company directors, a company might pay a portion of the company's profits to shareholders (referred to as a dividend). But the payment of dividends will have tax implications for the shareholders (because the dividend will count as income and potentially be subject to income tax). Dividend rates of tax differ to the Corporation Tax rates and Income Tax rates quoted above.

The other option for extracting money from the company is for a director to pay him/herself a salary (if an employee director). Being paid a director's salary means he/she would also have to take income tax into account when considering tax advantages and disadvantages; as he/she would likely (depending on the amount of the salary) have to pay income tax on that salary. So, for an owner/manager of a company, there are potentially 2 levels of tax to consider – Corporation Tax on the company's profits **and** Income Tax on a shareholder's dividend payments and/or director's salary.

Aside from considering tax, it would also be necessary to consider the implications of different rates of National Insurance Contributions (for which employee NICs **and/or** employer NICs could also be relevant). Employee National Insurance rates and Employer National Insurance rates can be found at <https://www.gov.uk/national-insurance-rates-letters>. For example, for the period from 6 January 2024 to 5 April 2024 employees (which directors generally are) pay NICs at rates of 0% if earning from £533 to £1,048 per month and 10% on earnings from £1,048.01 to £4,189 per month) and if more than £4,189 per month this excess amount over £4,189 would be taxed for National Insurance Contribution purposes at 2. The company meanwhile, from 6 April 2023 to 5 April 2024 would pay at various rates depending on the employees NIC category (depending on salary thresholds) at rates of anything up to 13.8%.

Meanwhile a sole trader will only have to pay self-employed Class 2 and Class 4 rates (see Guide 13.4 for more details on Class 2 and Class 4). Class 2 (depending on profits levels) can be £3.45 per week and Class 4 (depending on profit levels) can be 9% (profits between £12,570 and £50,270) with an additional 2% above the current set threshold of £50,270.

There are many factors to take into account when deciding which business vehicle is most tax efficient and seeking specialist input from an accountant or tax adviser is recommended.

For more on tax (including how dividends and director salaries are dealt with) see Guide 14. All of these issues need to be taken into account when considering which business vehicle is going to be best for the owners of a business; in terms of tax efficiency.

### **3.8 Table - Advantages and Disadvantages of Sole Trader**

<b>Figure 3.2</b>	
Advantages of being a Sole Trader	Disadvantages of being a Sole Trader
No actual formalities for setting up the specific Sole Trader business vehicle <b>but</b> a sole trader must comply with trading name and trading name disclosure requirements.	Lack of formal rules might make customers or suppliers wary of dealing with a sole trader.
A sole trader (as sole manager) has power to manage - with no restrictions.	Unlimited liability – big disadvantage (also for partners in a partnership) if claim made against sole trader, potentially personal assets (plus business assets) available to claimant (compare with company and LLP).
Sole trader not required to make accounts available to the public (compare with companies and LLPs).	Technically it is more difficult for lenders to take security (charge) over assets such as stock; consequently banks potentially less keen to lend to sole trader compared with a company/LLP for which the same difficulties do not arise.
Tax advantages and disadvantages (as compared with other business vehicles) should be carefully considered by your accountant to see which business vehicle is best for you; as each individual's financial circumstances will vary.	