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Making your side hustle legit: UK business entities explained

Nowadays, just about everyone has a side hustle. If you don't, what are you doing with all your free time and no extra money? In the past, a side hustle may have been a casual way to pad out your paycheque, but things change. Now, you need to go legit.

Before COVID-19 came along there was already a trend towards entrepreneurship and running second businesses on the side. With the pandemic and subsequent lockdown measures, the popularity of the side hustle has skyrocketed.

As restrictions lift but the spread of the virus continues, side businesses and second incomes are thriving. In the wake of this growth, the need to formalise operations becomes an important step. This means you need to think carefully about the business structure you want to implement.

Each option has different degrees of personal liability, tax responsibilities, administration work involved, and the potential to raise finances. Whatever startup ecosystem you're operating in, you need to make the right decision to give your side hustle the best chance of succeeding.

With that in mind, let's figure out what business entity suits your operation:

Self-Employed Status

As the most basic option, you can register yourself as self-employed. You'll be classified as such if you run your own business alone and are ultimately responsible for its success or failure.

A self-employed status is an option even if you work full time for an employer but earn extra income on the side. You won't be paid through PAYE but you will need to register yourself with Her Majesty's Revenue and Customs (HMRC) to process your annual tax returns.

The major advantage is that tax is based on profits and not total income. Your taxable contribution is determined by deducting expenses from income, making returns simple and straightforward.

With this status, employment law will not apply to you and all rights and responsibilities are dictated by the contractual terms you have with a client. However, you'll still be protected by health and safety and discrimination laws.

Sole Trader or Partnership

Sole traders are the simplest business structures, so the administration here is pretty minimal. You need to register with Her Majesty's Revenue and Customs (HMRC) but not with Companies House. This is because as Sole Trader, you and the company are considered one legal entity.

Limited companies (businesses that are legally separate entities from their owners) in the UK need to register with Companies House. This government organisation does exactly what it says on the tin; it incorporates and dissolves limited companies, and registers and publishes company details.

As a Sole Trader, all the profits are yours to keep as income, but you're also liable for all debts or legal actions. Plus, you need to pay national insurance and tax by completing a Self-Assessment Tax Return.

The big benefit is simplicity; the disadvantage is unlimited liability.

That unlimited liability extends not only to all your personal assets but also to any assets that you co-own with others. The same situation applies in a Partnership, which has the same legal obligations as a Sole Tradership but has more than one business owner – and thus a lot more in-person and online meetings.

Since all owners are liable but the company isn't incorporated, Partnerships are often called *unincorporated entities*. Profits are shared according to an agreedupon ratio, and everyone pays individual tax. Also, when one partner reneges on their responsibilities, all partners are liable.

Private Limited Company

Private Limited Companies are indicated by the abbreviation LTD at the end of their name. In the eyes of the law, they're separate entities from their owners, which means that shareholders' liability is limited. The company retains any profits and must pay Corporation Tax on them.

Once Corporation Tax has been levied, the LTD's profits are distributed amongst shareholders in the form of dividends. The remunerations are decided at the discretion of the owners, and the limits on the company are imposed either by shares or by guarantee.

Limitation by shares is more common and means that shareholders' financial responsibilities for the entity's financial liabilities are limited to their individual investments as well as any unpaid shares. Limitation by guarantee means that members act as guarantors.

In both cases, shareholders' personal assets are protected if a limited company must be dissolved.

That's a big advantage as the brand is protected from personal financial commitments or mistakes. Another major plus is that you can claim back business expenses.

However, some people are resistant to LTDs because their current appointments and filing history is publicly registered and accessible at Companies House making them very transparent. The extra admin that comes with incorporating (legally constituting) the business can also be a deterrent.

Public Limited Company

Public Limited Companies (PLCs) are public versions of LTDs and are run in similar ways. That means that members' liability is limited to their investment and share value, just as it is in a Private Limited Company. What makes them different is that a PLC's shares can be publicly traded, which opens up another way of raising money.

Being able to access extra finances (through public trading) is a major pro for PLCs, but it's balanced by a pretty significant con; much higher operating costs.

The minimum value of shares that must be issued before a company can be publicly listed is £50,000.

That’s no small sum of money, and a PLC is also legally required to appoint at least two directors. With these stipulations in place, publicly and privately listed companies are generally considered as more suited to larger and smaller enterprises respectively.

Limited Liability Partnership

Limited Liability Partnerships, usually known as LLPs, operate similarly to traditional partnerships by having the added benefit of limited liability. An LLP’s main objective is to generate maximum profits, and you’ll commonly see it in law practices and accounting firms.

In an LLP, at least two partners must be appointed designated members and assume responsibility for the daily running and administration of the partnership. Each member within the LLP can be an individual or another company, with duties and shares set out in the LLP Agreement.

Limited Liability Partnerships provide a relatively easy way to manage large entities, and they protect each member from excessive liability. The disadvantage of balancing out these advantages is the hefty amount of tax you’ll need to pay.

Not only must every member submit an annual Self-Assessment Tax Return, but they also have to pay income tax on their share of the LLP’s profits and pay the HMRC National Insurance. That’s why this structure is so well-suited to high-earning companies – such as accounting and law firms.

Limited by Guarantee Company

If you’re running a not-for-profit organisation, your best structure is a Limited by Guarantee Company.

Any profits that are generated are reinvested into the club or cause and used to achieve its (usually charitable) objectives.

Members are not really owners or shareholders; they’re classed as decision-makers and the rewards they get are usually not financial in nature.

Now you know your options, you should have a better idea of what direction you need to take your side hustle to turn it into a legit business.

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