

# Sole Trader or Limited Company?

by MGI Malta



This is definitely one of the major dilemmas that any trader has to face at some stage or another in his business life.

The answer is never clear-cut as one has to examine a variety of factors.

## Taxation

In the past, the most common factor that used to convince sole traders to convert to limited liability companies was tax savings. When the top personal tax bracket was 65% whilst company tax was only 32.5% this reason, even on its own, made a lot of sense.

However, since 1990 both the top personal tax bracket as well as the company tax rates were streamlined at 35%. Today there exists very little tax incentive to justify, on its own, the conversion of a business to limited company.



## Limited Liability

An important factor that, some would say, is even more important than taxation when evaluating such a decision, is the question of Limited Liability. This principle is rarely understood by the sole trader. The simplest way to explain it is by emphasising the following:

*“ As a sole trader, your business creditors have access to all your business assets as well as all your personal assets. As a limited liability company the only assets they can claim on are the business assets - provided that no mal-practice was committed by you whilst trading under a company name”*

This can be looked at as a Risk Umbrella that protects the personal assets of the trader should the business encounter any type of financial storm. The problems can result from the trader's inability to repay his/her creditors or from claims by a client, an employee or any third party seeking redress in court against the trader for presumed damages suffered.

For the above reason alone, it is always worth considering the limited liability company option. The additional costs involved in registering the company and the annual additional statutory costs, are a small price to pay for this peace of mind.

## Continuity

The transfer of the business assets from a sole trader to his heirs can sometimes be very cumbersome requiring the opening of the will, transfer of legal titles to property

etc. This can also be very costly, especially where a will is challenged in court. Such a challenge can spell the death knell for the business.

In the case of a company, as this is a legal person in its own right, the only procedure required is the transfer of ownership in the share capital. Its legal rights and obligations on its property, assets, debtors, creditors, bank facilities and employees are not disturbed. Therefore the business should encounter few problems in continuing to trade.

## Credit Facilities

First of all, the major providers of credit finance in Malta, i.e. the Banks, do not have any preference since, under their conditions for loans and/or overdrafts to companies, they always ensure that the directors provide a personal guarantee on the company's facilities secured by personal assets.

Many trade creditors nowadays have become much more restrictive as to credit terms in view of their experience over the past few years when some suppliers took some heavy losses.

However, having said that, with the increased reporting to the Registrar Of Companies by limited liability companies and the current ease by which anybody can obtain copies of such reports, in my opinion both banks and trade creditors would tender to favour a company. From these reports, at least, when they have any doubt, they can obtain a limited amount of financial information on their customer. Accounts of limited liability companies are normally prepared by qualified accountants according to strict international guidelines and covered by an auditor's certificate as to their truth and fairness, and therefore the reliability of such accounts is more secure. In the case of a sole trader only banks can demand a copy of the accounts, and in most cases these are not prepared to any standards and nor are they audited.

## Multiple Owners

When the business has more than one owner, and these are not husband and wife, the registration of a company is always recommended.

Under Maltese law, the administration of jointly owned property, including business assets, is subject to mutual consent. Therefore, unless all parties agree to it, no action can be taken. Also, unless a detailed partnership agreement is signed by all parties, such partnership is bound to run into difficulties at some date or another. These problems can become even more serious should one of the partners die, when the heirs have a right to be paid his/her share of the business which can mean the disposal of important business assets.

In the case of a company, this will always be covered by a partnership agreement called the Memorandum and Articles of Association in which, the partners become shareholders. Such a document, when properly drawn up, will normally cover for most eventualities, including the process of decision making when unanimous consent is not possible. This will ensure that the business will continue to function.

In the case of the death of one of the shareholders, the company's activities need not be affected severely, since as stated above –refer **Continuity** - the shareholders are distinct legal persons from the company itself. The heirs to the deceased

shareholder will simply inherit his/her shares but will have no right to force the company into liquidity problems by insisting on the liquidation of their shares.

## Multiple Businesses

When a trader has more than one business, it is always advisable to incorporate each into a separate company thereby ensuring that the problems of one business will have no effect on the other business. As a shrewd businessman once explained:

*“ Each business is like a boat floating on dangerous waters. If two boats are tied together, when one goes under it will pull the other one with it. So always leave each boat floating on its own”*

## Image

For the above reasons, an incorporated business normally enjoys more prestige, both with its suppliers and its customers.

Customers tend to think that a company has a better organisational structure, is more professional in its approach and has less chance of closing shop in the near future than a sole trader.

Also, suppliers, especially overseas ones, tend to look down on non-incorporated businesses as being small, unregulated and difficult to check for credit rating.

## Employment

For the same reasons as customers above, most people, nowadays, would prefer working for a company than a sole trader since they presume this gives them better job security and better career prospects.

## Other Matters

The Value Added Tax Act 1999 and the Social Security Act make no distinction with regards to duties under the same Acts.

Similarly the Conditions of Employment Act covering the rights and obligations of the employer towards his/her employees does not differentiate between the two.

Licensing regulations also apply in identical ways to both type of business, as do the Planning regulations.

As one can see from the above, various factors need to be considered when deciding on the best course of action and the sole trader would do well to give the matter serious consideration.

## Disclaimer

The above information is being provided as a general guide only and should not be considered as a substitute for professional advice.



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