



Department for
Business, Energy
& Industrial Strategy

Understanding the Reasons for Incorporation

Final Report – Policy Summary

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1. Introduction

1.1 Summary

The study provides evidence on business owners' reasons for company incorporation and the value of different aspects of incorporation status. A stated preference methodology was used, which allowed for a broader view on the choice on whether to operate as a limited liability company (LLC) or sole trader (ST). The stated preference survey was developed through multiple rounds of testing and revision, building on initial qualitative research to understand the context for the research question and the characteristics and perceptions of owners of small businesses. The survey was implemented with a representative sample of small business owners (LLCs and STs with between 0 and 9 employees). The study data and results satisfy key criteria concerning the validity of the survey responses and the research findings are judged to be reliable for use in policy analyses.

As would be expected a multitude of prior experiences and perceptions shape business owner's decisions over legal status. The survey results show that most LLCs and STs seek advice when setting up their business. Accountants were the most common source of advice for both LLC and ST business owners, while STs also more commonly sought advice from family and other people in their sector than LLCs. The choice to operate as a LLC reflects a range of considerations for business owners, with protection of personal finances (i.e. limited liability), making it easier to secure contracts, and opportunities to grow the business being the most frequently cited reasons.

The total value of company incorporation to owners of LLC with 0 to 9 employees in the UK - which represents approximately 89% of LLC businesses in the UK by company size (by number of employees) - is estimated to be approximately £9.6 billion per year. Of this, the greatest proportion of the value is associated with limited liability, accounting for around 80% of the benefit to business owners (approx. £7.7 billion per year).

The wider study results align with expectations. For example, LLC business owners place greater value on limited liability and incorporation overall compared to ST business owners. Owners of larger businesses have higher values for limited liability and incorporation overall, compared to smaller business owners.

There is also a strong preference for the 'status quo' for a large proportion of business owners operating as STs. By and large this is attributed to greater importance of lifestyle and convenience factors for STs, compared to motivations that underlie the choice to incorporate, such as future business growth. Indeed, considerations such as "being own boss" and work life balance, along with ease of setting up business were the most frequently stated reasons given for operating as a ST.

The study results indicate that marginal changes in the effective annual fee for company incorporation - the combination of the initial incorporation fee and ongoing annual filing fee - would have a modest impact on the number of businesses operating as LLCs. For example, an annual fee of £100 per year has an estimated impact of reducing the total number of small LLCs (less than 10 employees) by about 3% (approx. 55,000 businesses). At higher fee levels the predicted impact is more substantial. An annual fee of £1,000 gives an estimated 30% reduction in the number of small LLCs (approx. 560,000 businesses), whilst a £5,000 annual fee would reduce the number of small LLCs by around 85% (approx. 1,500,000 businesses).

Two scenarios are presented to examine the potential effects from changing the company incorporation “package”. In both instances - removal of the requirement for public record filing and an increase in tax liability for LLCs - changes in the regulatory regime lead to relatively modest reductions in the number companies expected to incorporate at different annual fee levels.

Overall, the study demonstrates that the choice to incorporate a business is not solely based on financial or administrative burden factors that are within the direct control of business regulation and policy-making. Whilst these factors do matter and at the margin changes in incorporation fee, tax liability, and administrative requirements will impact LLC business formation, a richer set of influences also matter and in some cases are more material to business owners than the direct policy levers.

1.2 Policy context and purpose of the research

In 2019 there were an estimated 5.9 million private sector businesses in the UK. The vast majority were small businesses - approximately 5.82 million had between 0 and 49 employees - with medium and large business with 50 or more employees accounting for just under 1% of the total number of businesses. Sole proprietorships (“sole traders”) represented the largest proportion of small businesses (59% of the total), followed by limited liability companies (LLCs) (34%).

There has been rapid growth in the number of incorporated companies in the last decade. In 2018 – 2019 alone approximately 673,000 new companies were registered. This was an increase of 8.5% compared with the previous year¹. However, the reasons for the increase are not well understood. It is not known why a large proportion of business owners choose to incorporate as LLCs rather than operate as (registered) sole traders².

In general, the Government has encouraged company incorporation by making the process for registering a LLC straightforward with minimal associated financial cost³. There are, though, ongoing associated costs such as the additional administrative requirements and loss of financial privacy. From a ‘rational choice’ perspective the interpretation is that business owners expect that the benefits of incorporation outweigh the potential costs. To fully examine policy reform options that may alter incentives for business owners to incorporate it is important to have a clearer understanding of this choice - to understand what the most important demand factors are, and measure and quantify their effect on the rate of incorporation.

The approach to this study interprets company incorporation as an *individual choice* made by a (small) business owner. Adopting a micro-level perspective focuses the analysis on the driving factors that influence the choice of a business owner to set up and run a business as either a LLC or a ST. The aim was to provide evidence on the reasons why business owners decide to incorporate their business or not, including the relative influence of different characteristics of business status (i.e. LLC or ST). The study also looked at whether there are significant differences in the benefit of incorporation to business owners with different personal characteristics (e.g. gender and ethnicity). Finally, the research places a monetary valuation on

¹ Companies register activities:2018 to 2019. Available at:

<https://www.gov.uk/government/publications/companies-register-activities-statistical-release-2018-to-2019/companies-register-activities-2018-to-2019>

² Incorporation means a company becomes its own legal entity. This requires registration as a limited company at Company House, the UK’s registrar of companies and an executive agency and trading fund of the Government.

³ <https://www.gov.uk/government/publications/incorporation-and-names/incorporation-and-names>

selected attributes of company incorporation, alongside wider evidence on the reasons why small business owners (<10 employees) decide to incorporate or not.

1.3 Methodology

Stated preference method

The study used a stated preference methodology, which is a survey-based approach that presents respondents with simulated choices to measure their preferences and valuations for particular goods, services or outcomes. These methods are often used to value the provision of non-priced or non-market outcomes (e.g. environmental quality). Company incorporation – including limited liability – for the most part represents a non-priced outcome, since only a nominal fee is charged for company registration and associated ongoing annual filings⁴. Therefore the incorporation fee and ongoing annual fee (e.g. for annual filing) is unlikely to reflect the value that LLC business owners derive from incorporation.

The central component of the stated preference survey was a ‘choice task’, that asked a representative sample of small business owners to make choices about different options for the legal status of their business. The choices that respondents made reveal their priorities (demand) for the company incorporation package. This included varying levels of an annual fee for incorporation (i.e. initial incorporation fee plus ongoing fee associated with annual filing). The trade-offs respondents made between the fee amount and other aspects of the incorporation package reveal the value they derive from its provision. This value is measured in terms of the business owner's willingness to pay (WTP). It provides measures of the benefit that business owners gain from the incorporation package, including limited liability⁵.

Sampling approach

There were several potential sources from which to identify the target population for the stated preference survey. The Business Population Estimates (BPE), national statistics produced by BEIS, was chosen as the preferred source since covers both companies and sole traders and can also be broken down by business size.

A stratified sampling approach was adopted and five distinct sub-populations (strata or segments) were defined based on company size (LLC with 0, 1-4 or 5-9 employees; ST with 0 or 1+ employees). The rationale for a stratification based on company size is that the choice on the part of a business owner to opt for LLC status may in part be driven by a business planning strategy that envisages growth of the company and increased number of employees. Hence the materiality of factors related to – for example - transfer of ownership or recruitment may differ across segments. A random sampling approach was applied to the target population, with the intention that the segments would naturally fall out of the sample and approximately align with the population characteristics.

A combination of panels was used to construct the sample as no single source provided the required coverage of the target population at sufficient size for the sampling requirements. These included: the Companies House User Panel - for sampling (mainly) LLC owners; an

⁴ For example, it costs £12 to register a company on-line and £13 to file a confirmation statement once a year.

⁵ Willingness to pay (WTP) is a measure of economic value. It applies (universally) to all types of goods and services, whether they are traded in competitive markets, provided in a regulated market setting (e.g. energy), or non-market (e.g. open-access public sector information).

online business to business (B2B) panel; an online consumer panel for self-employed business owners; and telephone recruitment of business owners to the online survey.

2. Findings

2.1 Summary statistics

Sample profile

The completed sample features approximately 1,500 business owners, with a roughly even split between LLCs (47%) and STs (53%). The largest proportion of LLC respondents were sourced from the Companies House panel (45%). Most ST respondents were sourced from commercial panel providers (96%). The breakdown of respondent numbers by legal status and business size by source is presented in Table 1.

Table 1. Number of respondents by source (n = 1,530)

	Online panels		Company House panel		Telephone recruitment		Total	
	ST	LLC	ST	LLC	ST	LLC	ST	LLC
0 Employees	337	19	20	67	0	115	357	201
1 Employee	275	41	11	94	0	0	286	135
2-4 Employees	107	69	7	140	0	0	114	209
5-9 Employees	63	32	0	27	0	106	63	165
Total	782	161	38	327	0	221	817	713
	943		365		221		1,530	

In the sample, twice as many LLCs were owned by males than females⁶, while ST owners were evenly split between males and females. ST ownership was more skewed to the young (18 to 44) than LLC ownership. The proportion of White British / Irish and other ethnicity business owner was the same for LLCs and STs. In general, ST ownership was more heavily weighted towards education attainment up to first degree, while LLC ownership was more heavily weighted towards those with a higher degree or professional qualification.

⁶ BEIS analysis of company directors recorded on FAME also suggests that the male to female ratio is 2:1, thus the sample is in line with the general population, especially as for the size of company covered the director will often be the owner.

Business formation

Business owners reported that a range of factors influenced their decision regarding legal status, such as prior experiences and general perceptions:

- **Advice:** Most LLCs and STs did seek advice when setting up their business. Where sought, accountants were the most common source of advice for both LLCs and STs, although to a greater degree for those who decided to incorporate. STs more commonly sought advice from family and other people in their sector than LLCs, although LLCs also consulted these sources. The most common topics consulted on were tax liability, limited liability, and administrative requirements across both STs and LLCs; although limited liability advice was more frequently sought by LLC respondents.
- **Key considerations for legal status:** A range of factors were considered important by LLCs business owners, with protection of personal finances (i.e. limited liability), making it easier to secure contracts and opportunities to grow the business being the most frequently cited. These factors are primarily related to operation of a business and maximising the chances of success. A different range of factors tended to be considered as most important by STs, with "being own boss", work life balance, ease of setting up business, and keeping all profit being the most frequently cited. Notably in comparison with LLCs, these factors are more related to quality of life and ease of doing business.

2.2 Value of company incorporation

Business owner willingness to pay

The value of incorporation is estimated in terms of business owner WTP for attributes of the company incorporation package shown in Table 2. For LLC respondents, the value of *company incorporation* overall ranges from approximately £4,000 per business per year for companies with zero employees to approximately £8,000 per business per year for companies with 5-9 employees. Across the three LLC segments, around 80% of the value assigned to company incorporation is attributed to limited liability (77% for 0 employees; 81% for 1-4 employees; 84% for 5-9 employees). An interesting finding is that no value is assigned to public record requirements, which could be viewed either as an administrative burden or a source of legitimacy. The result signifies that LLC respondents were largely ambivalent to filing requirements and making company records public - i.e. this was not perceived as either an advantage or disadvantage of a given legal status for a business and therefore did not strongly influence choices between alternative options.

Table 2. Value of company incorporation – mean (average) WTP per year (£/year/business)

	LLC 0 employees	LLC 1-4 employees	LLC 5-9 employees	ST 0 employees	ST 1+ employees
Limited liability	£3,070 (£2,440 - £3,700)	£5,220 (£4,230 - £6,210)	£6,710 (£3,990 - £9,420)	£820 (£580 - £1,060)	£2,110 (£1,260 - £2,950)
Public record	-	-	-	-£280 (-£470 - -£90)	-£560 (-£1,080 - -£30)
Company name Registration	£940 (£530 - £1,350)	£1,160 (£630 - £1,690)	£1,250 (£20 - £2,470)	£640 (£420 - £860)	£1,410 (£530 - £2,300)
Total value of incorporation	£4,010 (£2,970 - £5,050)	£6,380 (£4,860 - £7,900)	£7,950 (£4,010 - £11,890)	£1,180 (£530 - £1,830)	£2,960 (£710 - 5,220)

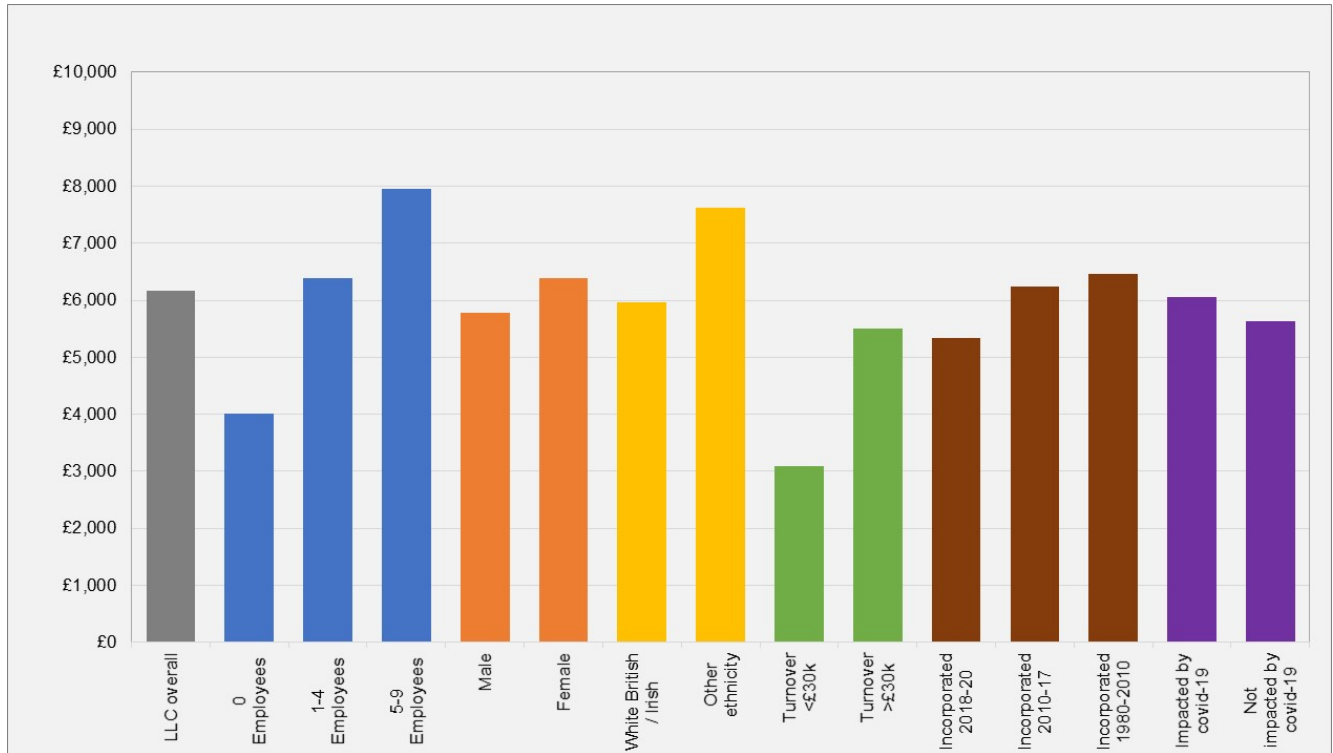
Notes: All values are rounded to the nearest £10. Lower – upper bounds reported in parenthesis 95% confidence interval.

The value of company incorporation for ST respondents is lower in comparison to the LLC results. It ranges between approximately £1,200 per business per year for the 0 employee segment and approximately £3,000 per business per year for the 1+ employee segment. In relative terms, less weight is assigned to limited liability (69% 0 employees; 70% 1+ employees) compared to the LLC results. Accordingly, company name registration accounts for a larger proportion of the overall value for ST. The value for the public record requirement is found to be negative (approx. -£300 to -£600/business/year), signifying it is a disbenefit to ST business owners – i.e. this is amount business owners would need to be compensated for annual filings.

Willingness to pay by business and business owner segments

Figure 1 compares the value of company incorporation overall for the main LLC sample segments to a wider breakdown of business owner and business characteristics. The respective sample size for each segment is between 114 and 599 respondents. The overall value of company incorporation is relatively consistent across the different segments. For example, there are minimal differences in WTP between male and female business owners, or in relation to the age of the business. The clearest distinction is for company size in terms of turnover (less than £30k vs. more £30k), which largely represents the pattern in WTP shown in the main results relating to company size by number of employees. This indicates that the willingness to pay for company incorporation is subject to a budget constraint. This finding gives confidence in the survey results in that respondents do not appear to have been engaging in "cheap talk", where they value incorporation without considering what the business could afford to pay.

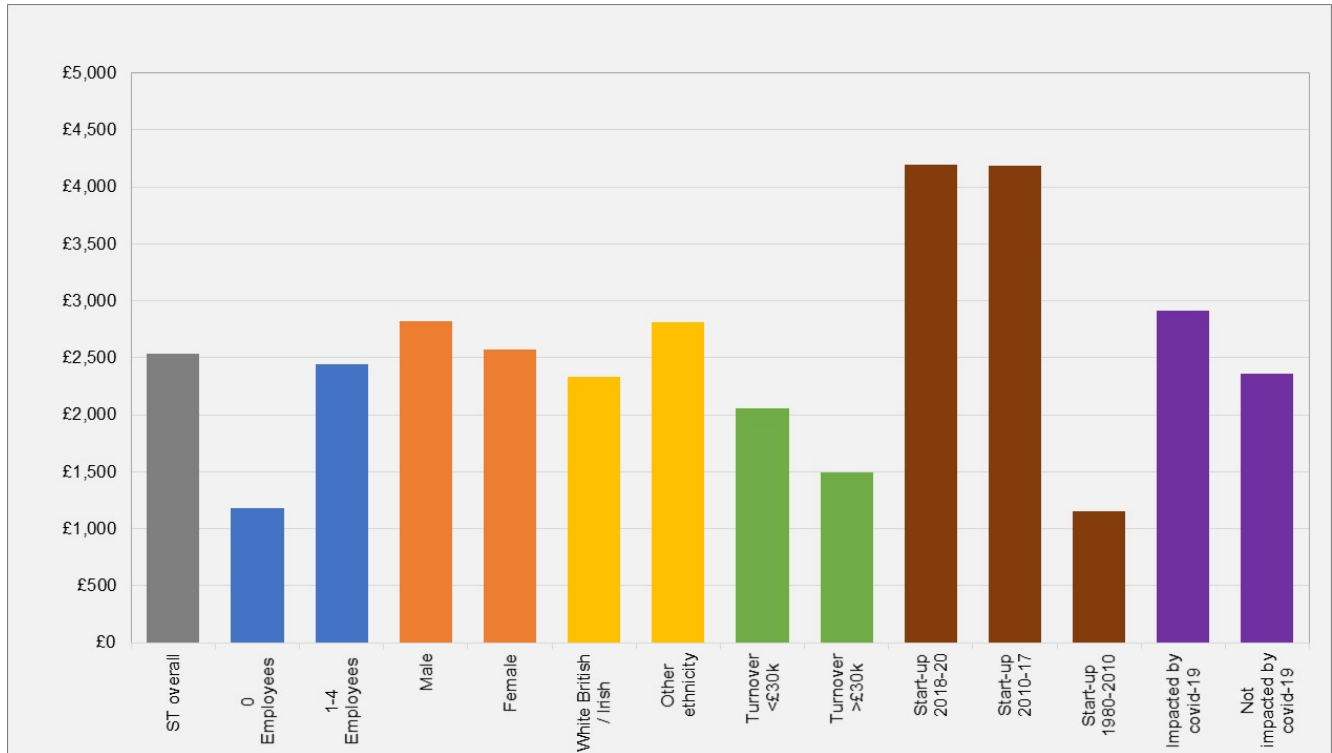
Figure 1. Comparison of WTP for company incorporation - by business owner and business characteristics – LLCs (£/year/business)



Notes: Sample sizes (n). LLC overall = 713; LLC 0 employees = 202; LLC 1-4 employees = 345; LLC 5-9 employees = 166; Male = 468; Female = 235; White British / Irish = 599; Other ethnicity = 114; Turnover less than £30k = 188; Turnover greater than £30k = 525; Incorporated 2018 - 2020 = 139; Incorporated 2010 – 2017 = 328; Incorporated 1980 - 2010 = 231; Impacted by covid-19 = 460; Not impacted by covid-19 = 253.

Equivalent comparative results are shown in Figure 2 for ST business owners. Sample sizes are between 114 and 702 respondents for each segment. Generally, there is a similar level of consistency in the estimates, although the effect with respect to company turnover as a constraint is less marked. Instead, there are more pronounced differences in WTP by company size based on number of employees as well as the age of the business, with business owners who set up their business between 2010 and 2020 placing greater value on incorporation than owners of more established businesses set up prior to 2010.

Figure 2. Comparison of WTP for company incorporation - by business owner and business characteristics – STs (£/year/business)



Notes: Sample sizes (n). ST overall = 817; ST 0 employees = 357; ST 1+ employees = 460; Male = 410; Female = 397; White British / Irish = 702; Other ethnicity = 114; Turnover less than £30k = 555; Turnover greater than £30k = 262; Start-up 2018 - 2020 = 223; Start-up 2010 – 2017 = 336; Start-up 1980 - 2010 = 253; Impacted by covid-19 = 455; Not impacted by covid-19 = 362.

Note that in both the LLC and ST segments, those impacted by COVID-19 and those not impacted by COVID-19 have similar WTP values, indicating that respondents took a longer-term perspective when making their choices.

Effect of prior experience of legal status

The overall sample included a number of business owners who indicated that they had switched legal status either from operating as an LLC to a ST (n=63), or from operating as an ST to a LLC (n=74). Whilst the respective sample sizes for these “switchers” are too small to report reliable representative results for, the findings are informative (Table 3). The current LLC (but former ST) value for company incorporation is in line with the overall LLC value (Table 2). The ST current (but former LLC) value is higher than both the 0 employee and 1+ employee valuation for incorporation, potentially suggesting a greater appreciation for the benefits of company incorporation, despite having switched to ST.

Table 3. Comparison of value company incorporation for business owners who have switched business status (£/year/business)

Business status change	WTP for company incorporation
Current ST (former LLC) (n=63)	£3,560 (£280 - £6,850)
Current LLC (former ST) (n=74)	£5,860 (£2,970 - £8,760)

Value of current legal status - STs

A notable result from the analysis of the choice task responses is the relative attractiveness of the current situation for STs. This effect is shown by the estimate of the value placed on the current situation by ST respondents (Table 4).

Table 4. Value of current legal status - mean (average) - ST business owners (£/year/business)

Segment	Value of ST status
ST overall (n=817)	£6,420 (£5,910 - £6,940)
ST – 0 employees (n=357)	£8,200 (£7,510 - £8,880)
ST – 1+ employees (n=397)	£5,050 (£4,320 - £5,780)
ST (former LLC) (n=63)	£1,670 (£170 - £3,500)

For STs, the key observation is the calculated value of the status quo is greater than the value of company incorporation (Table 2). Validity testing of the survey responses indicates that this result is consistent with the reasons highlighted by ST respondents for their choice of legal status (i.e. wider lifestyle and convenience factors). Based on this, it is reasonable to conclude that aspects of the company incorporation package such as the administrative burden or (current level of the) registration fee are not the key determining factors for a reluctance on the part of a ST to incorporate. Moreover, modest adjustments to these requirements are unlikely to have a significant effect on the rate of incorporation from existing STs. Indeed, the perception from supporting interviews with ST business owners was that their choice of legal status meant they were able to achieve a better work-life balance and maintain more control over their time than they would as an LLC. Overall, there can be a significant ‘lifestyle’ aspect to operating as a ST for many individuals, which is not fully compensated by the benefits of company incorporation.

Value of current legal status - LLCs

Equivalent analysis for LLC respondents is framed around the disbenefit of being forced to switch to ST status from their current LLC status. This can be interpreted as the value of the current situation for LLC business owners in terms of the amount an owner would need to be compensated for if they were to switch to ST status (Table 5).

Table 5. Value of current legal status - mean (average) - LLC business owners (£/year/business)

Segment	Value of LLC status (disbenefit of ST status)
LLC (n=713)	£3,700 (£3,420 - £3,980)
LLC – 0 employees (n=202)	£3,230 (£2,720 - £3,740)
LLC – 1-4 employees (n=345)	£3,940 (£3,550 - £4,320)
LLC – 5-9 employees (n=166)	£3,780 (£3,150 - £4,410)
LLC (former ST) (n=74)	£3,750 (£2,890 - £4,600)

Overall, the value of the current situation to LLCs is observed to be consistent across the business size segments, as well as for those LLCs which used to operate as STs.

Business owner sentiment on achieving their business objectives and other factors influencing their business legal status:

Ensuring a good work-life balance was a key objective [...] and working for themselves.

- ST 5 – 9 employees

The legal obligations of being of a company director were not fully explained [...] it would have been considerably more helpful to have understood these responsibilities.

- LLC, 1 – 4 employees

Quite familiar with limited liability companies from previous role [...] this was the simplest approach and did not want to make 'life more difficult than was necessary', by adopting a more complex business structure involving more administration and taxation procedures.

- ST, 1 – 4 employees

Business plan objectives were growth, both in terms of turnover and employee size, so being a sole trader did not match the ambitions, and so was aware that LLCs were better suited.

- LLC, 5 – 9 employees

The requirement to file accounts and other records with Companies House was seen as a positive because 'it keeps it all above board' and 'knew exactly where they were' [...] contrary to being an administrative burden, it gave a sense of confidence in how the business was running.

- LLC 1 – 4 employees

Changing status from sole trader to LLC meant that the business had turned into 'proper company that gives it more strength on stage when trying to win business'. As such, it acted as a catalyst to help grow the company.

- LLC 1 – 4 employees

The overwhelming reason for choosing LLC status was one of legal entity – 'if the company is failing, it's reassuring that they can't take money from us and that our assets are safe'

- LLC 1 – 4 employees

Strongly agreed with the statement 'it is important to focus on non-financial reasons for being a sole trader or incorporation, such as reputation, level of control, and privacy'.

- ST 1 - 4 employees

Being a sole trader was the simplest way of running their own business. With the ease of set up and low start-up costs [...] effortless to manage in conjunction with bringing up their family.

- ST 1 – 4 employees

3. Policy analysis

3.1 Aggregation of benefits

The aggregate annual benefit for company incorporation is calculated as the average value per LLC multiplied by the total number of LLC businesses. Table 6 reports the aggregate benefit for each company size segment using the business population estimates in the BPE (0 employees, 1-4 employees, and 5-9 employees), presenting both the value of limited liability only and the whole company incorporation package.

Table 6. Annual aggregate value of limited liability and company incorporation

	LLCs 0 employees	LLCs 1-4 employees	LLCs 5-9 employees
Value of limited liability (£/year/business)	£3,070	£5,220	£6,710
Value of incorporation (£/year/business)	£4,010	£6,380	£7,950
Number of businesses (BPE; 2020)	945,545	631,900	218,945
Annual aggregate benefit – limited liability (£m/year)	£2,904m	£3,298m	£1,469m
Annual aggregate benefit - incorporation (£m/year)	£3,793m	£4,033m	£1,742m

Summed across the three company size segments, the total value of limited liability to business owners of small (i.e. less than 10 employees) UK companies is estimated to be £7.7 billion per year. The total value of incorporation to owners of small UK companies is estimated to be £9.6 billion per year.

3.2 Illustrative policy scenarios

The study results also provide a basis for estimating the effect of different “*what if*” policy scenarios. The first step is to estimate the demand for company incorporation by predicting the number of LLCs that would exist under different price points, which represent the annual fee for company incorporation (the initial incorporation fee and then ongoing annual filing fee). The demand schedules for LLCs with 0 employees and LLCs with 1 to 9 employees are presented in Figure 3 and Figure 4, respectively.

Figure 3. Demand for company incorporation (LLCs with 0 employees)

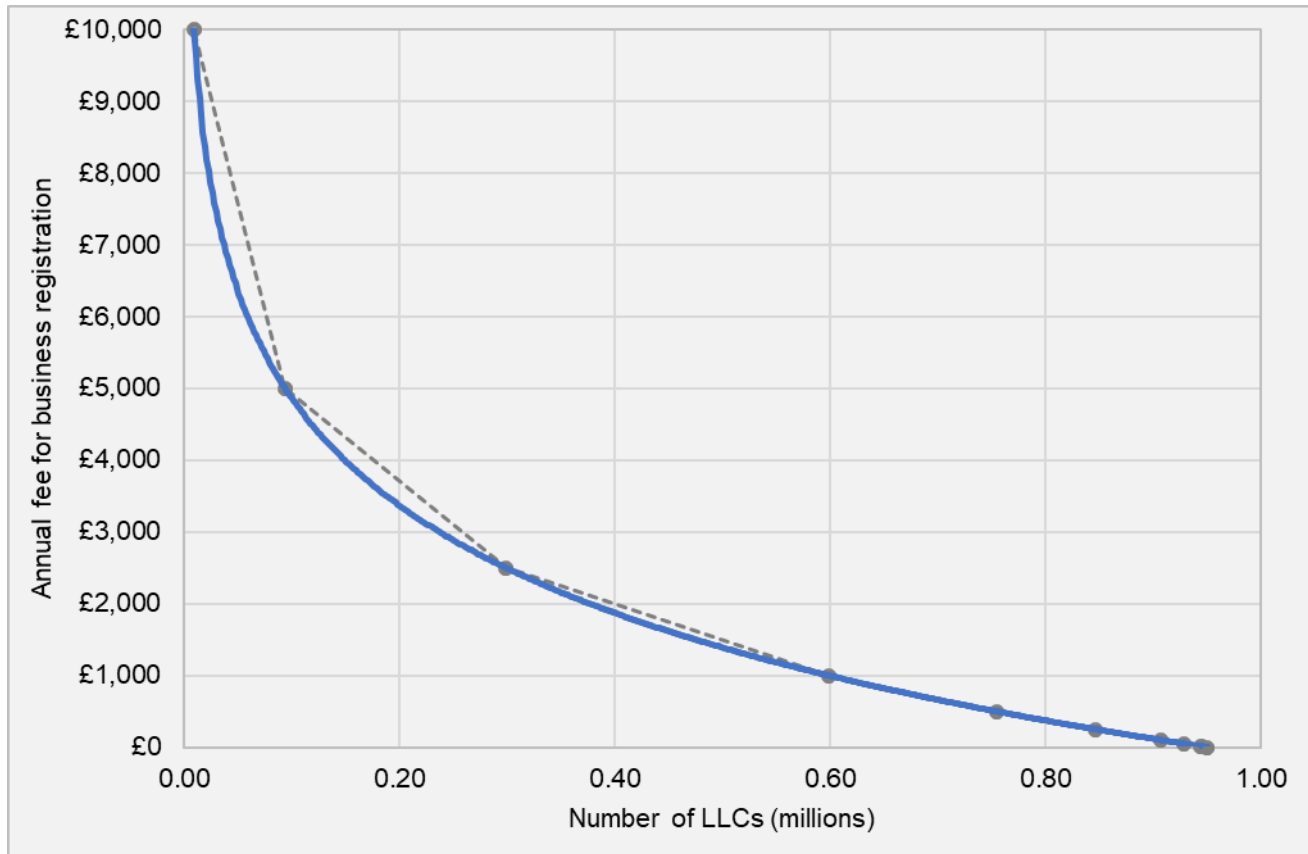


Figure 4. Demand for company incorporation (LLCs with 1 to 9 employees)

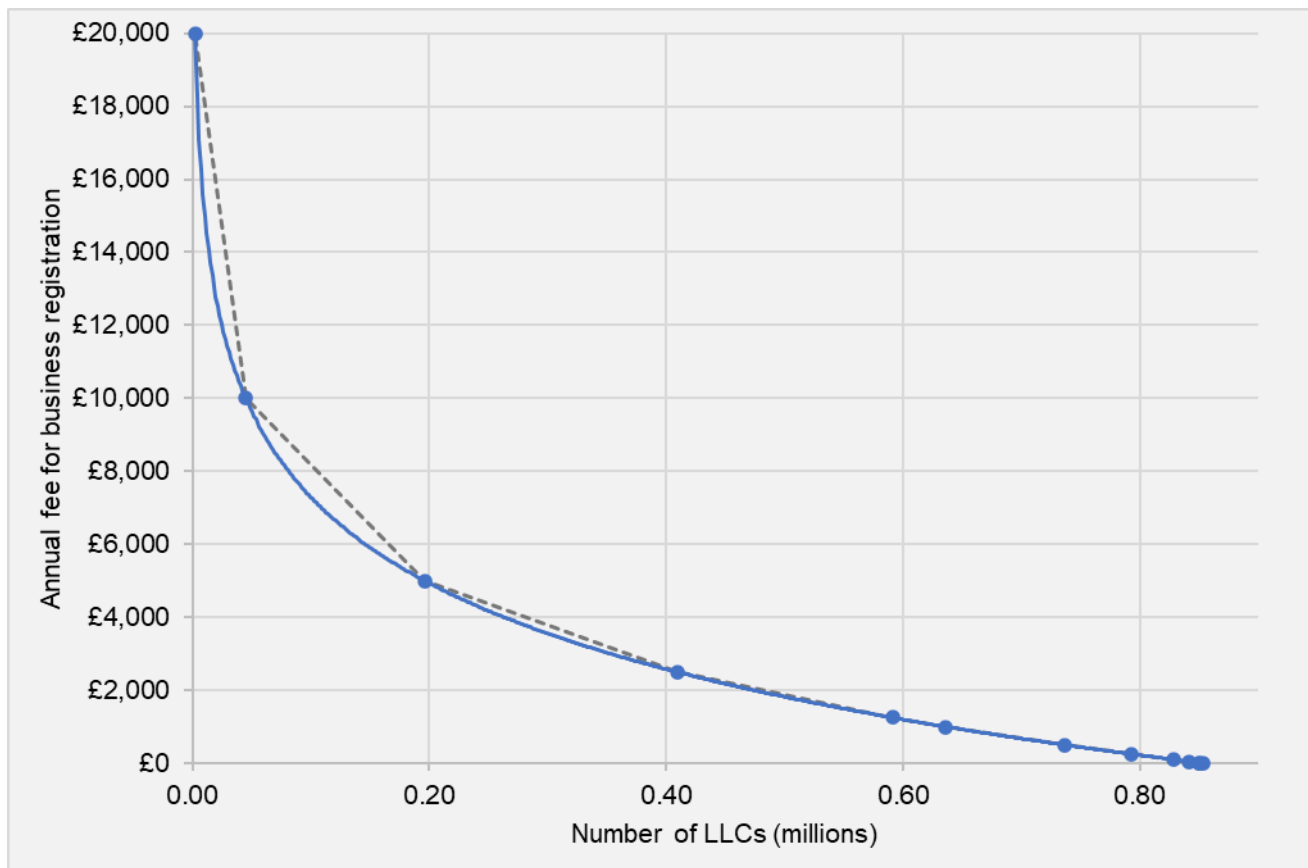


Table 7 reports the estimated number of LLCs at each price point corresponding to the demand schedules shown above⁷.

Table 7. Estimated number of small LLCs at varying price points ('000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to "current" demand (%)	LLCs (1-9 employees)	Compared to "current" demand (%)	Total LLCs (0-9 employees)	Total Compared to "current" demand (%)
£0	951	101%	854	100%	1,805 [+10]	101%
£15	944	100%	850	100%	1,794 [-]	100%
£50	929	98%	841	99%	1,770 [-24]	99%
£100	908	96%	829	98%	1,737 [-57]	97%
£500	755	80%	737	87%	1,492 [-303]	83%
£1,000	599	63%	636	75%	1,235 [-559]	69%
£2,500	299	32%	409	48%	709 [-1,086]	39%
£5,000	94	10%	196	23%	291 [1,504]	16%

From this baseline, the effect of alternative policy scenarios on the predicted number of incorporated companies can be assessed. The policy scenarios are 'simulated' using the choice task model results and specifying alternative company incorporation packages (see Technical Report). Two indicative policy scenarios are simulated: (i) a case where public record filing is no longer a requirement of incorporation; and (ii) a case where the tax "benefit"

⁷ Note that the reduction in LLCs at higher price points does not represent the termination of the business, but that the business owner may opt to operate as a ST rather than pay that fee to be a LLC. Therefore, the economic activity from businesses that switch from LLC to ST is not necessarily 'lost' but rather occurs under a different legal status.

of incorporation (vs. ST status) is reduced. Case (ii) is modelled as a £1,000 increase in annual tax paid by LLC business owners.

Indicative policy scenario (i): no public record filing requirement

The estimated number of LLCs under different price points for the no public filing requirement scenario is reported in Table 8. At the (approximate) current price point (£15 per year) there is an estimated 6 percentage point reduction in the number of 0 employee LLCs and a 2 percentage point reduction in the number of 1-9 employee companies. The fairly marginal effect is consistent with the relatively low level of importance of the public filing requirement observed for LLC respondents in the main choice task results.

Table 8. Estimated number of small LLCs at varying price points – no public filing requirement ('000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to current demand (%)	LLCs (1-9 employees)	Compared to current demand (%)
£0	899	95%	839	99%
£15 (approx. current price)	892	94%	835	98%
£50	878	93%	827	97%
£500	713	75%	724	85%
£1,000	566	60%	625	73%
£2,500	283	30%	402	47%
£5,000	89	9%	193	23%

Indicative policy scenario (ii): reduction in tax benefit

The estimated number of LLCs that under different price points for the increase in tax liability (£1,000 per year) is reported in Table 9. At the current (approximate) price point there is greater reduction in the number of incorporated companies compared to scenario (i) - in region of 12 to 17 percentage points for the company size segments.

Table 9. Estimated number of small LLCs at varying price points - £1,000 increase in tax liability ('000s of LLCs)

Annual fee for business registration	LLCs (0 employees)	Compared to current demand (%)	LLCs (1-9 employees)	Compared to current demand (%)
£0	791	84%	755	89%
£15 (approx. current price)	786	83%	752	88%
£50	773	82%	744	87%
£500	628	66%	652	77%
£1,000	498	53%	563	66%
£2,500	249	26%	362	43%
£5,000	78	8%	174	20%

For businesses that continue to operate as LLCs, the increase in tax liability (£1,000 per year) represents a transfer of wealth to the exchequer rather than a net economic loss. Likewise, some of the businesses that cease to operate as LLCs would switch to operate as STs, and the reduction in tax benefit (i.e. increase in tax owed) would also represent a transfer to the exchequer. However, it cannot be assumed that all companies that cease to operate as LLCs would switch to ST status. Some business owners may prefer not to operate at all and this effect would represent a net economic loss⁸.

4. Conclusion

Company incorporation, and limited liability that comes with it, is a valuable service provided by the government to business owners. The total benefit created is substantial, and with only a nominal administrative fee paid for this service, most of the benefit that is created goes to the private sector (i.e. business owners). As a (quasi) non-market good, the value created from company incorporation is not well understood and does not appear in national statistics. The stated preference approach applied by this study provides a means to understand both the value of incorporation, and the value of specific components of incorporation, such as limited liability. This evidence is a useful contribution to understanding the reasons for incorporation and its value.

The results from this study should be understood as a partial account of the total societal benefit of company incorporation. The analysis is focused on small business – defined as

⁸ For example, owners of businesses with low revenue who decline to operate as an LLC in the absence of the tax benefit, may also decline to operate as a ST due to the additional cost to the business from public liability insurance to replace the limited liability benefit of incorporation, thus ceasing to be economically active.

those operating with 0 to 9 employees - and the benefits accruing to business owners. There is additional value to larger LLC employers, as well as broader societal benefits, for example from increased risk taking (i.e. due to limited liability) and transparency (i.e. due to requirements for public record filing). While some of the benefit of incorporation may be realised elsewhere (e.g. public liability insurance is available from the market for a price comparable to the WTP for limited liability), the government effectively subsidises these goods through the incorporation process, encouraging businesses to operate as LLCs.

From an individual business owner perspective there is a clear cost versus benefit equation in the decision to incorporate or not. Indeed, the study results show there is a preference for the ST status for a subset of the total population of business owners that is based around non-economic factors, and the loss of these benefits would outweigh any gain from company incorporation. This finding helps illustrate that the choice to incorporate a business is not based only on financial or administrative burden factors that are within the direct control of business regulation and policy-making. Whilst these factors do matter and at the margin changes in incorporation fee, tax liability, and administrative requirements will impact LLC business formation, a richer set of influences also matter and in some cases are more material to business owners than the direct policy levers.

This publication is available from: www.gov.uk/government/publications/understanding-the-reasons-for-forming-a-company

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