Getting Your Corporate Structure and Related Legal Documents in Order

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This handout is intended to aid you in choosing the corporate structure that is most appropriate and best-fitted to your business aims and ideas. It outlines the different corporate structures in the UK, how to form them, and the advantages and disadvantages associated with each one.

There are different types of corporate structures that can be used to carry on business activities, and they can be either unincorporated or incorporated. For unincorporated entities the owner does not have a separate identity from the business, the consequence of that being that the owner has unlimited liability. On the other hand, incorporated entities are formally constituted and possess a distinct legal personality.

Link to slides: https://docs.google.com/presentation/d/1hifd6LXsSbNN5mMxvBAmSSpku-p2UJAxhEJNQ4T30Uo/edit?usp=sharing

Sole Trader

Sole trader is a term used to describe an individual carrying on business on his or her own. There is no distinction between the identity of the individual and that of the business. The owner of the business is also responsible for the day-to-day management of the company. The sole trader is also fully liable for the debts incurred by the business. A sole trader can carry on business using his or her real name or a different name. Once registered, this is known as a business name.

Formation:

There are 3 steps you must follow to become a sole trader, the gov.uk website has the details:

- Set up as self-employed (a 'sole trader'): step by step - GOV.UK (www.gov.uk)

Sole Trader	
Advantages	Disadvantages

- Simplest form of a business structure
    - Fewer statutory obligations as there is no need to register with Companies House
    - Register with Her Majesty's Revenue and Customs (HMRC) to pay self- employed National Insurance Contributions (NIC)
- Complete control over your business
- More privacy as there is no need to file information publicly
- Lower setup and accounting costs due
	- Unlimited personal liability
	    - a sole trader is open to liability for all of the business's debts and losses
	- Limited access to finance
	    - due to lack of transparency, investors will be hesitant to lend large sums without security over personal assets
	- Fewer tax planning opportunities
	    - less flexibility as profits earned by sole trader are subject to income tax in the same financial year they were

to lack of professional assistance + full profit retention from your business
- More flexibility
  - easy to alter your corporate structure if needed
	made
	- Cannot bring in investors or IPO/ List on stock exchange
	- Succession
	  - Death of the sole trader can end the business

Limited Liability Partnership

A partnership consists of 2 or more persons coming together for a common purpose. Prior to 2001, only two forms of partnerships existed; ordinary general partnership, regulated by the Partnership Act of 1890, and the limited partnership formed under the Limited Partnership Act 1907. These partnerships have no separate legal personality. The partners share the risks, costs and responsibilities of being in business, and they generally bear the consequences of each other's decisions. Partners can raise money for the business out of their own assets, and/or with loans. Again, being unincorporated limits borrowing in practice, and not being a company with a share capital prevents the business from raising equity finance from issuing shares.

In 2001, the Limited Liability Partnerships Act went into effect, and this introduced a third form of partnership, Limited Liability Partnership (LLP), which is a corporate body with a legal personality of its own. The LLP can be thought of as a hybrid between a company and a partnership. LLPs do not have shares, and unless otherwise agreed between the partners, there is no obligation for the partners to contribute capital. LLPs are 'tax transparent' i.e. HMRC looks through the LLP ignoring its existence and treats profits of the LLP as if they have been earned by the members (partners) themselves (just as in an ordinary partnership). The LLP structure is commonly used by professional services firms such as law firms or accountants because the owners in these businesses tend to also be the managers, a feature of LLPs. Professional services firms also favour this structure due to its flexibility in comparison to companies limited by shares: it is easier to join and leave the partnership, compared to a shareholder in a company limited by shares, who would need to find a buyer for their shares (which in a private company are often illiquid). Partners in an LLP also prefer this as it gives them limited liability, whilst maintaining the tax advantages of an ordinary partnership.

Formation:

To form the LLP you will need to:

- Choose a name
  - See point 6 of Incorporation and names on the GOV.UK website: Incorporation and names - GOV.UK (www.gov.uk)
  - See also 'choose a name' part of Set up and run a limited liability partnership (LLP) - GOV.UK (www.gov.uk)
- Have a registered address - this will be publicly available
- Have at least 2 'designated members' – these are the members of the partnership who are required to perform certain administrative duties which are equivalent to a director or a secretary in a private limited companies
- Have an LLP agreement that says how the LLP will be run
  - *Note:* there is no legal requirement to have an LLP agreement. The LLP agreement is a private document and therefore you do not need to file this with Companies House.
- Register the LLP with Companies House

LLP's are registered at the Companies House. See the GOV.UK website for a comprehensive outline of the formation of LLP's: Set up and run a limited partnership - GOV.UK (www.gov.uk).

If you are unable to register your LLP using a third-party software or by using a formation agent, then you can fill in a form to register the LLP.

- See Form LL IN01: [LL IN01 Application for the incorporation of a Limited Liability Partnership (LLP) (publishing.service.gov.uk)]

The legal document required to set up an LLP is the LLP agreement. The LLP agreement sets out how the LLP will be run. Some of the provisions it contains are:

- How profits are shared among members
- Who needs to agree decisions
- Members' responsibilities
- How members can join or leave the LLP

A solicitor can help you prepare an LLP agreement or you can write one by yourselves.

Limited Liability Partnership	
Advantages	Disadvantages

- Limited Liability
  - Separate legal personality
- Shared responsibility, expertise and capital
  - The more partners there are the more there is finance available to invest into and develop your business
- Shared profit - tax advantages
  - Taxed at personal level as the profit passes through its owners who will then report their share on their individual tax return
- Privacy
  - Affairs of a partnership can remain confidential
- Organizational flexibility
	- Fewer tax planning opportunities
	- Limited access to finance
	- Cannot bring in investors or IPO/ List on stock exchange

Private Company Limited by Shares

A private company limited by shares is an incorporated entity with a separate legal personality from its owners. This means that the company can carry on business and enter into contracts in its own name distinct from its owners, thereby limiting the liability of its owners.

Where a company is 'limited by shares', this means that the company has shareholders, and the liability of the shareholders is generally limited to the amount, if any, that remains unpaid on the shareholder's shares. When setting up the company, you can issue different 'classes' of shares by setting out those classes in the company's articles of association, with each class of shares given a name (e.g. they are sometimes identified by letters of the alphabet - A shares, B shares, C shares etc.). Each class of share can provide for different rights including voting rights, rates of dividend payments and various other rights. This means you can give different rights to different shareholders.

The private company limited by shares distributes profits to its shareholders in the form of dividends after it retains working capital for the business and after it pays the required corporation tax (and any other taxes which it is required to pay).

A private company limited by shares must have at least one director and at least one director must be a natural person. The management of the company is separate from its ownership and undertaken by a director or board of directors. However, directors may also be members (shareholders) of the company. Where a company has just one shareholder, such shareholder can be both the sole member and sole director of the company.

Furthermore, a private company limited by shares has the option to convert into a public limited company (PLC) and can then list on a stock exchange via an initial public offering (IPO). Unlike a private company limited by shares, a PLC is allowed to offer its shares for sale to the public. A PLC must have at least two directors and a qualified company secretary, and it must have issued shares to the public to a value of at least £50,000. Public companies attract stricter regulation than private companies to ensure transparency and protection for the public investor.

Formation:

To form a private company limited by shares, see Set up a limited company: step by step - GOV.UK (www.gov.uk). Currently, the price of registration with the Companies House is £12.

The most important documents in creating a private company limited by shares are the memorandum of association, the articles of association and Companies House Form IN01; as these are required to register your private company limited by shares with Companies House.

The Memorandum of Association:

This is a basic legal document signed by all initial shareholders (known as 'subscribers') at the time of the formation of a company.

- A template for this can be found here: Give notice of subscribers: company with share capital - GOV.UK (www.gov.uk)

The Articles of Association:

This is the main constitutional document of the company. It sets out, amongst other things, rules on the management and organisation of the company. This is agreed upon by the shareholders.

- Where a company does not wish to create its own bespoke articles or amend the model articles, the model articles are automatically applied to the company.
- Model articles of association for companies limited by shares can be found find here: Model articles of association for limited companies - GOV.UK (www.gov.uk)

Form IN01:

This form needs to be filled in in order to register the company. The information that goes into this form includes: the company name, company type, address of the registered office, particulars of the directors and company secretary etc.

- See : IN01 Application to register a company (publishing.service.gov.uk)

There are further legal documents to consider, such as the shareholder agreement.

Shareholder Agreement:

This regulates the relationship between shareholders and the company itself. The agreement sits alongside the articles of association of the company; but unlike the articles of association, it is not legally required as it is a private document that does not need to be filed with the Companies House. The shareholder agreement sets out the rights and obligations of shareholders, and describes how the company is going to be run and creates protections/ground rules for both shareholders and the company.

- See: [Online Publication qLegal Word, Shareholder Agreements, 15.4.21 (qmul.ac.uk)]

Private Company Limited by Shares	
Advantages	Disadvantages

- Limited liability - less risk
  - Personal possessions are not at risk in case of business' failure
- Additional sources of equity finance
  - Sale and issue of shares, ability to have an IPO if converted to a PLC
  - Allows for complex structuring
- Prestige - transparency, order and professionalism
  - Registry at Companies House provides transparency, credibility and attracts investors
- Flexibility - different classes of shares with different voting rights can be issued
- Transferability of shares - liquidity
  - Can easily transfer shares from one shareholder to another person
- Reduced tax liability
  - 19% corporation tax on profits compared to 20-25% income tax for sole traders
  - Allowed combination of dividends and salary, dividends allowance provides with an annual allowance of £2,000
  - Pre-tax trading income can be put in company's pension schemes
  - Sharing income among family members will minimize the tax liability for each person
	- Personal guarantee
	  - Personal assets can be at risk if a personal guarantee is given by shareholders
	  - BUT, can consider personal guarantee insurance to mitigate the risks
	- Form of structure can be complicated
	- Statutory obligations
	  - Statutory breaches and Criminal Liability
	- Less privacy - public records available to anyone on Companies House's website
	- Costs – depending on complexity of company, large amount of paperwork can be needed, requiring professional assistance from an accountant and lawyers
	- Administration and filings - directors need to record information on monthly and yearly basis to comply with Companies Act 2006 filing and disclosure requirements