Corporate & Commercial

Carter Lemon Cameron

JUNE 2014

SETTING UP SMALL TO MEDIUM ENTERPRISES

Different Types of Corporate Entities

Models for delivering your business

Part 2 - ‘Which is the right vehicle for you?’

The big step to consider when starting a new business is which business vehicle to adopt.

As explained in the first part of this two part series there will be a number of factors to consider. How risk averse are you? Do you want to take on personal liability or limit your liability? There are plenty of issues to think about when choosing the right vehicle. You should seek legal and tax advice to ensure you choose the most appropriate form of set up. Our Corporate Team together with our wealth and tax advisor can assist you to ensure you choose the right vehicle to meet your objectives.

There are a number of options to consider. The structure you choose will define your legal responsibilities, such as:

- the paperwork you must fill in to get started and then maintain on an annual basis
- the taxes you’ll have to manage and pay
- how you can personally take the profit your business makes
- your personal responsibilities if your business makes a loss

The most common business structures in England and Wales used by SME’s are: sole trader, partnership and company.

Below is a summary of the differences in the structure:

SOLE TRADER	
Key features An individual who trades on their own account. Typically small independent businesses will find this structure most attractive. A sole trader is able to employ staff but, typically, a sole trader business will involve only a single individual.	
Advantages	Drawbacks
• Few formalities in creating the business and low set-up costs. • Full control of the management of the business with little red tape. • No requirement on the sole trader to publicly disclose any information.	A sole trader will not have the benefit of limited liability. You will be personally liable for all debts incurred by, or claims made against, the business.

(Continued on page 2)

(Continued from page 1)

Tax considerations

- You would effectively be self-employed and manage the business finances in the same way – filling in a self-assessment tax return at the end of the year with your business income, expenses etc and paying income tax and National Insurance.
- A sole trader's profits are taxed as income by HMRC and you will need to register for self-assessment.
- Capital gains on disposals of assets.
- Capital allowances can be claimed on eligible assets.
- VAT registration is mandatory upon exceeding the registration threshold.
- National Insurance Contributions (**NICs**) are payable by sole traders.

PARTNERSHIP

Key features

This is formed automatically when two or more people enter into business together with a view to making a profit; often it is an extension of the sole trader business. Although not legally necessary for a partnership to exist, our Corporate Team would always advise the partners to enter into a written agreement to govern how the liabilities, ownership and profits of the business are split and what happens if a partner dies or leaves the business.

Advantages	Drawbacks
• Flexibility to choose the management structure. • Not so heavily regulated, although certain statutory regulations must be complied with • Financial information is not required to be publicly disclosed.	Generally each partner is jointly and severally liable for the debts of the business. As with sole traders, the partners will each be personally liable for debts incurred by the partnership or claims made against it.

Tax considerations

- Each partner will pay income tax at the applicable rate of his share in the partnership on trading profits and he will need to register for self assessment.
- Each partner will be assessed for capital gains tax on an individual basis.
- Capital allowances can be claimed on eligible assets owned by the partnership or owned by one of the partners and used for the benefit of the partnership.
- VAT registration is mandatory upon exceeding the registration threshold.
- NICs are payable by each partner.

(Continued on page 3)

(Continued from page 2)

LIMITED LIABILITY PARTNERSHIP (LLP)

Key features

An LLP is similar to a company in that it exists in its own right, and the liability of the owners is limited. The difference is, the liability of the owners is limited to the amount of money they have invested in the business and to any personal guarantees they have given. There is not the same distinction between shareholders and directors (owners and management) that limited companies benefit from; instead the LLP must have at least two "designated members".

Advantages	Drawbacks
• Partners have limited liability for all debts incurred. • LLPs benefit from the same organisational flexibility as a general partnership and, by means of a written LLP agreement, the members of an LLP can set out how the liabilities, ownership and profits of the business are split and what happens if a partner dies or leaves the business.	• A high level of public disclosure is required to be made through filings of forms and documents at Companies House. The LLP will need to publicly disclose its annual accounts. • An LLP must have at least two 'designated members' and so would not be suitable for a single individual.

Tax considerations

The members of the LLP pay income tax on their share of the profits just as in a conventional partnership, so they have the advantage of self employed status but lose the ability to plan with salaries and dividends. Each member's share of profit is taxed as income and each member must register with HMRC as self-employed.

PRIVATE COMPANY LIMITED BY SHARES

Key features

A limited liability company exists in its own right, and has its own legal personality. The company is owned by the shareholders who approve the appointment of the directors The directors (as a board) run the day to day operation of the Company.

The shareholders usually have the ultimate say in the way the company is run because they determine who the directors are.

Shareholders have limited liability, but directors have a statutory duty to promote the 'success' of the company under the Companies Act 2006.

Liability of the shareholders is limited to the amount they have agreed to pay on the shares which remains outstanding.

(Continued on page 4)

(Continued from page 3)

Advantages	Drawbacks
• A private limited company is often viewed as more credible by banks, investors and other businesses. • Offers a range of methods for raising finance. It can be financed by grants, loans (secured and unsecured) and by equity. Dividends are paid from generated surpluses and are not, therefore, a cost of the business (unlike interest on a loan). Shareholders are only rewarded if there are profits available for distribution. • A company allows for some tax planning. • Directors are paid a salary and this cost is a company expense	• Running a limited company means a lot more paperwork and compliance with company law and meeting more deadlines compared to being self-employed. • Directors have employment rights, which partners generally do not. • Generally the shares in a private limited company cannot be sold or transferred to anyone else without the agreement of other shareholders. • Directors of a private limited company must comply with certain statutory and other duties and may find themselves personally liable in situations where they breach them. • A high level of public disclosure is required to be made through filings of forms and documents at Companies House. The private company will need to publicly disclose its annual accounts. • As you will see by now there is much more administration work involved with running a Limited Company than as a sole trader or partnership. The decision you make as to the structure of your business will depend on what your capabilities are and your level of confidence as to the business's potential success.

Tax considerations
The tax regime is more favourable to a registered company than to a sole trader. Limited companies pay corporation tax on their profits and their company directors are taxed as employees. The corporation tax rate on profits up to £300,000 is 20% and for profits between £300,000 and £1.5m, it is 23.75% and profits over £1.5m are taxed at 23%.

(Continued on page 5)

(Continued from page 4)

COMPANY LIMITED BY GUARANTEE

Key features

A company limited by guarantee is like an ordinary private company limited by shares, but it does not have share capital or any shareholders. Rather it has members who control it. Companies limited by guarantee do not distribute their profits to their members by dividends, but usually retain them within the company for the overall benefit of its members or the advancement of the company.

There is no liability on members to contribute to the company's capital while the company is solvent but they are liable to the extent of the amount they have agreed to guarantee on a winding up, this is usually a nominal sum. The amount that members undertake to contribute is not an asset of the company but a contingent liability of members.

Typically this form of business structure is suitable for charitable organisations and residents management companies.

<table>
<tr><th>Advantages</th><th>Drawbacks</th></tr>
<tr><td>

The company may adopt bespoke articles of association articles but if not will follow model form which will be registered for the company.
Each member guarantees to contribute a certain sum to the company in the event of it being wound up. In the event of a winding up, the members’ liability is limited to the amount that they each agree to contribute.
Members have limited liability.
The company needs only appoint one director (subject to any additional requirements in its constitution).
It is not mandatory to appoint a company secretary.
As there are no shares, there are fewer formalities in relation to issuing share certificates and maintaining share capital.

</td><td>

Members’ interests cannot be mortgaged or charged by the company while it is a going concern.
A high level of public disclosure is required to be made through filings of forms and documents at Companies House. The company limited by guarantee will need to publicly disclose its annual accounts but it will not need to specify who its members are.
The fact that there are no shares means that it is difficult to realise income and capital value in the business. It is also not possible to raise funds through equity finance.

</td></tr>
</table>

Tax considerations

As a company registered by shares.

(Continued on page 6)

(Continued from page 5)

Starting a business can be both exciting and stressful. But, with careful planning which include obtaining legal guidance, the process can be smoother.

Before getting started it is advisable to discuss all the available options with your legal advisors. The type of vehicle you choose will depend on your type of business and estimated turnover. Seeking early legal and tax advice will help ease some of the pressures you face.

Once you have decided on structure, it does not stop there… you will also want to consider the constitution of the business; a memorandum of association or articles of association will be needed for a company and a shareholders agreement or partnership agreement is advisable to regulate the conduct of the business as between its members.

If you wish to raise finance via a private investor make sure that you get the agreement in writing and have it checked by a solicitor. Be clear about the terms of this investment. Make sure that you are aware of the consequences of accepting it. Our Banking Team has a wealth of experience on advising SME on financial documents. We also have very close links to a number of neighbouring banks in the city who have dedicated teams to assist SME's. We work closely with other professional advisers to ensure your objectives are met.

Bharti Gorasia *(Solicitor)*
Corporate and Commercial Team
BhartiGorasia@cartercamerons.com

For further information please contact:

Stuart Brennan *(Partner)*
Company Commercial
StuartBrennan@cartercamerons.com

Andrew Firman *(Partner)*
Employment
AndrewFirman@cartercamerons.com

Justin Cumberlege *Partner)*
Healthcare
JustinCumberlege@cartercamerons.com

Rufus Ballaster *(Partner)*
Real Estate
RufusBallaster@cartercamerons.com

Michael Woodward *(Consultant)*
Wealth Advisory and Tax
MichaelWoodward@cartercamerons.com