Why Your Enterprise Needs to Think About a Corporate Structure?

Disclaimer: This handout describes the law in general terms. It is not intended to provide legal advice on specific situations and should not be relied upon as a source of legal advice.

This brochure will help you through the basics of why you should choose a corporate structure for your company and which structure would be best applicable for your style of business. Business structures help you to avoid possible monetary loss or liabilities that can arise in the future. You will be liable for the debt of your business. If due to some circumstances, your business cannot afford to pay back the debt, your personal assets would be exposed. It is best to avoid this potential financial burden and start protecting your assets from the beginning. It can get a little confusing, but we are here to make this easy for you. So, get yourself acquainted with the types of business models, and let us know which structure would work for you.

I. What does a corporate structure mean?

For this workshop, "corporate structure" refers to the external legal corporate structure of a company. It means a category of an organization that is legally recognized in the UK. In this handout, we focus on four main structures: sole trader; partnership; private company limited by shares; and community interest company.

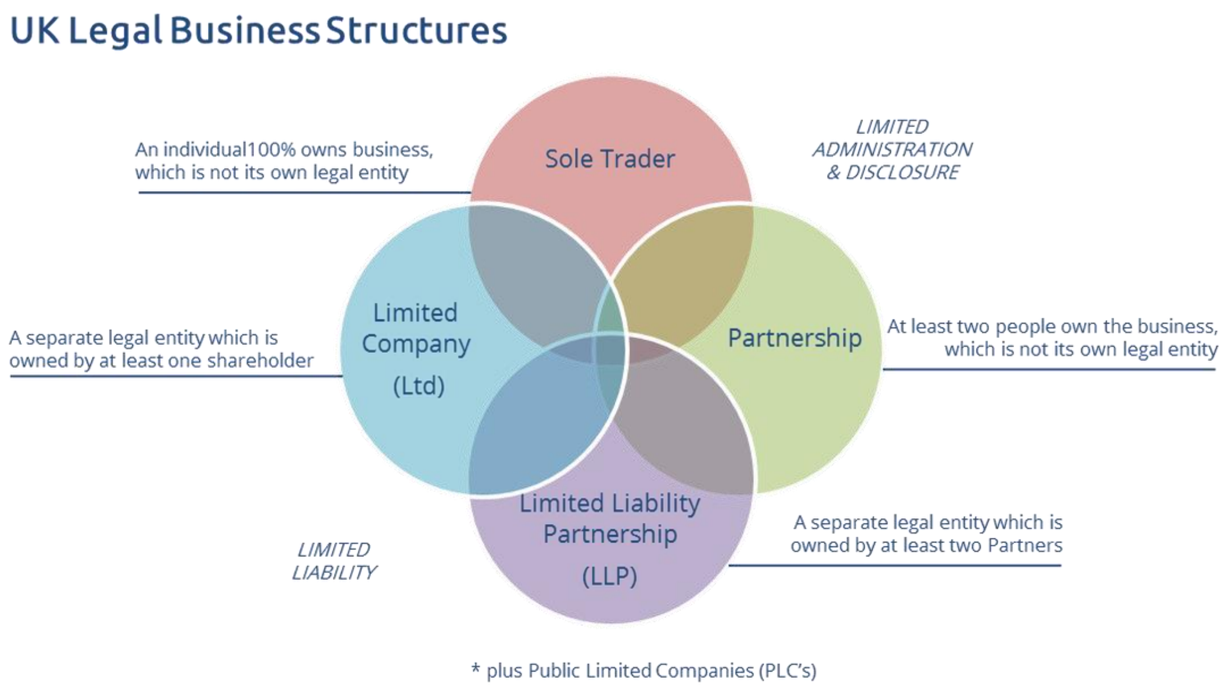
The type of legal structure that you choose will affect the following: the amount of control that you have over your own business; the amount of tax you will have to pay; your liability if your business incurs losses or liabilities; the registration process when your business is established; the way your business can raise funds; and how executive decisions are made with regards to the business.[1]

For example, a partnership is a small scale of the business where two or more people cooperate to manage and finance the business with trust. So, a partnership may not be the most appropriate legal structure for a big-scale business that requires the privilege of limiting personal liability and greater mobilization of capital than may be provided by a small number of people. The difference between a partnership and a more formal structure such as a private company limited by shares

[1] https://companieshouse.blog.gov.uk/2018/07/18/choosing-the-right-business-structure/

brings with it a changing set of legal roles and responsibilities, which the parties might not wish to bear. Therefore, such an external corporate structure is considered a key determinant of the activities which the business can undertake.

II. Types of corporate structures in the UK and what each of them consist of?



(UK Legal Business Structures[2])

What sort of company?

There are more than 1 million companies registered in the UK and of those, fewer than 2,500 are public companies listed on the stock exchange. Most of the others are sole traders or partnerships that have been formed into companies to achieve limited liability for the owners, to ensure perpetual succession, or to secure more favourable tax treatment. There are also subsidiaries, often wholly-owned, which have been registered to differentiate a separate line of business or to provide (or protect) a trading name, and charities where incorporation (usually as companies limited by guarantee) simplifies administration - for example, in holding investments. Statistics: Over the last 2 decades of the 20th century, the UK has had a substantial increase in the number of businesses in operation. The number has increased from a million in 2000 to 6.0 million in 2020.

[2]http://www.ventapartners.co.uk/latest-news/which-business-structure-is-best-a-quick-guide-to-the-options-for-small-businesses-in-the-uk

III. <u>Advantages and disadvantages of each structure</u>

Corporate structure	Advantages	Disadvantages
Sole trader	• Do not need to register with the Companies House. • Full power to control and make decisions for the business. • Minimum capital requirement. • Keep all profit.	• No separate legal personality. • Unlimited loss and personal liability. • Hard to find sources of capital. • Sole trader being analysed as an employee and do not have a separate legal entity.

General Partnership	• Easy to set up. • More potential to raise funds than a sole trader.	• No separate legal personality • Unlimited liability for business's debts and obligations which affect all partners in general partnership. • If the problem between partners cannot be solved, you may need to restructure the business structure among any remaining partners.
Private company limited by shares	• Limited liability protection. • More potential to raise funds. • Ability to transfer interests of the company (shares). • Tax benefits.	• Set-up costs. • Publicly filed annual accounts and financial reports. • Company expenses (ex. audit fee and accountant fee). • Duties of director.
Community Interest Company (CIC)	• Inexpensive and easy to set up • Limited liability protection. • Compared with a charitable company, the CIC has flexibility to carry out the mission of the organization. • Fewer reporting and administration requirements.	• Comply with company regulations, such as the CIC report must be published publicly. • No tax incentives.

IV. How do I set up each type of corporate structure, and what key documents does each type of entity need?[3]

Sole Trader

[3]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31676/11-1399-guide-legal-forms-for-business.pdf

- Registration requirement: You have to choose a name for your business, either your name or another branded name. Registration of the chosen name with the Companies House, the official Registrar of Companies in the UK, is not a requirement. The trading name should (i) not be offensive; (ii) should not include 'limited', 'Ltd.', 'limited liability partnership', 'LLP', 'public limited company' or 'plc'; and (iii) should not be confusingly similar to an existing company's name.
- Taxes and other payments: You also need to register for tax and keep records for tax purposes. You must inform the HM Revenue and Customs (HMRC) that you intend to pay taxes through the "Self-Assessment" process and also keep records of the sales, profits, and tax liabilities for future reference. When your annual turnover exceeds £85,000, you must register for Value Added Tax (VAT).

General Partnerships

- Registration requirement: Partnership law stipulates certain terms and conditions concerning the governance of a general partnership and hence a formal written partnership agreement with your fellow partners is a good idea. However, a general partnership does not have to register with the Companies House.
- Taxes and other payments: The nominated partner should register the partnership for the Self-Assessment process with the HMRC by October 5th of the second business year, followed by the other partners registering separately as individual taxpayers. If the business' annual taxable turnover is above £85,000, the nominated partner will also have to register for VAT.

Private company limited by shares

- Registration requirement: Companies must be registered with Companies House and the company should have a unique name to get approval from the Companies House. A very important governing document called the articles of association must be adopted during the company's incorporation process, which essentially outlines the rules and regulations of the company and its members and officers.
- Taxes and other payments: Each year the director of the company will have to submit the accounts, along with a confirmation statement (an "Annual Return"), and deliver them to Companies House. The annual accounts and company tax return will also have to be submitted to the HMRC on a yearly basis. The profits generated by the company will be liable for 19% Corporation Tax. If your annual turnover exceeds £85,000, you will have to register for the Value Added Tax.

Community Interest Company (CIC)

- Registration requirement: To set up as a CIC, you will have to register online with the Companies House or apply by post, similar to registering as a normal company with the same incorporation documents. A "community interest statement" will be asked from you, which explains what your business plans to do for the benefit of the community. You will also have to provide an "asset lock," a legal promise, which states that the company's assets will only be used for a community benefit. After approval from the CIC Regulator, your company will be ready to operate.
- Taxes and other payments: CICs are liable to corporation tax and are required to prepare and deliver accounts, a CIC report, and an annual return, to the Registrar of Companies on a yearly basis. These companies are subject to the same regulatory requirements as normal companies. However, they are exempt from an audit as long as (i) their turnover is less than £10.2m; (ii) their total assets are less than £5.1m; and (iii) they have fewer than 50 employees. It is important to note that there is no exemption from VAT for a CIC that is engaging in trading activities. VAT is a tax on the annual turnover and is based on the nature of goods and services supplied by the company in question. Those enterprises that are operating without a profit motive are still liable to pay VAT, but those in the education, health, or welfare sector may find exemptions. (Refer to the HMRC website for further information)

V. Conclusion

The company model best suited for your business will depend on a variety of factors, including the number of assets you own or the threshold of liability you are comfortable with. Consider the advantages and disadvantages outlined above. Either you are just starting and are confident to face everything on your own (i.e., be a Sole Trader) or you want the liabilities to be distributed among your business partners. One more factor to consider is whether you want a separate legal personality that keeps your assets protected.

The information we have provided to you does not constitute professional legal advice. It is intended to give you an idea about the types of business structure available to you. To apply for individual legal advice from qLegal, please go to this website:

http://www.qlegal.qmul.ac.uk/advice/

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