Why Your Enterprise Needs To Think About A Corporate Structure

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The slides accompanying the workshop and handout can be found here: https://docs.google.com/presentation/d/1QsbZsVP7bJE_S6clcCwSUtGC1SkI10e_n6i7_33gEvo/edit?usp=sharing

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.

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)](https://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
	- 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

- More privacy as there is no need to file information publicly
- Lower setup and accounting costs due to lack of professional assistance + full profit retention from your business
- More flexibility
    - easy to alter your corporate structure if needed
	sole trader are subject to income tax in the same financial year they were made
	- Cannot bring in investors or IPO/ List on stock exchange
	- Succession
	    - Death of the sole trader can end the business

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 of shareholders 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
	- 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

- Reduced tax liability - 19% corporation tax on profits compared to 20-45% 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 minimise the tax liability for each person	filing and disclosure requirements

Community Interest Companies (CIC)

A company limited by shares or a company limited by guarantee may be incorporated as or become a community interest company and therefore be established for charitable purposes or for the benefit of a community (social enterprise), but is not treated as a charity. The purpose of a CIC is primarily one of community benefit rather than private profit. They are easy to set up and have all the flexibility and certainty of the company form, but with several special features such as:

- Must satisfy 'the community interest test" which includes promotion of education, arts, environment, social welfare, sports, etc.
- Restriction on transfer of company's assets to ensure they are used for the benefit of the community.
- Subject to caps on dividends and interest payable – to strike a balance between encouraging people to invest in CICs and the principle that the assets and profits of a CIC should be devoted to the benefit of the community.

CICs were first established in the UK in 2005. Since then, they have grown considerably, both in number and in the diversity of the activities they undertake. The CIC legal structure supports a wide range of activities; they range from very small local projects to multi-million pound health services, covering all industry sectors. Each CIC is required to submit on a yearly basis a report detailing the activities undertaken and how these have benefited the community. This is an important document as it sets out publicly exactly how the CIC has met its obligations to deliver community benefits. Also, this is designed to ensure that the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community. In addition to the annual report, the CIC is also required to provide the annual accounts and a confirmation statement.

A fundamental feature of a CIC is that the transfer of the assets of a CIC are restricted and can only be used for the benefit of the community. This concept is known as 'asset-lock' and it means that, the assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must be made (a) at full market value, (b) if the transfer is made for less than full market value then such transfer must be to another CIC or other asset locked body which shall be either (i) identified in CIC's articles or (ii) occur with the consent of the Regulator; or (c) for the benefit of the community.

Formation:

There are 2 ways to form a Community Interest Company (CIC)

1. Convert an existing private company limited by shares or guarantee into a CIC
2. Form a CIC directly

Turning an existing Company into a CIC

In order to convert an existing private company limited by shares or guarantee into a CIC you will need the following the documents:

a. Form CIC37
b. Complete the model special resolutions to convert a company into a CIC
c. Amend your existing articles of association to include provisions relevant to CIC
d. Form NM01

You will then need to send the documents and pay the required fees.

Form CIC37 or community interest statement -

- In this form you indicate how the proposed activities of your CIC will benefit the community or a section of the community. You also have to explain how you think your company will be different from a commercial company providing similar services or products for individual or personal gain. This form will be sent to the community interest companies regulator who are the ones who decide whether the proposed company is eligible to become a community interest company.
- This form will be placed on the public register and made available to download.The Regulator of Community Interest Companies views the community interest statement as a key feature of community interest companies and therefore the opportunity should be taken to showcase your intended activities and champion the benefits you intend to deliver to your community.
- See: CIC37: application to convert a company to a CIC - GOV.UK (www.gov.uk)

Model special resolution to convert a company:

- Here you must complete the model special resolution to convert a company into a CIC by stating that the company should become a community interest company
- You should also make such alterations of the articles of association as it considers necessary to comply with the requirements imposed by, and by virtue of section 32 or otherwise appropriate in connection with becoming a community interest company; and
- To change the company's name by including replacing the designate ltd with CIC or community interest company
- See: model-special-resolution-convert-company-to-cic.doc (live.com)

Amend your existing articles of association:

- You have to ensure that all of the mandatory clauses that apply to CICs are included. These clauses are highlighted in red in the model articles of association and can't be removed or altered.

Complete form NM01: notice of change of name by resolution

- You file this form to Companies House to notify them of the change of name by the company members. You must change the 'Ltd' designate found at the end of the name of your private company limited by shares to 'cic'. You must do this in order to convert a private company limited by shares into a CIC.
- There is a cost of £10 to file the paper form. Otherwise you can file form NM01 online and it costs £8.
- See: Change a company name (NM01) - GOV.UK (www.gov.uk)

Sending in the documents and paying the fees:

- You must send all your documents to the registrar of companies house with a cheque for £25 made payable to companies house. The £25 includes the £10 fee to change of name.

Forming a (CIC) directly:

- To set up a CIC directly you will have to register with Companies House, this can be done online or through the post.
- If done online, you will have to upload the pdf versions of the CIC36 Form and Articles of Association. A digital version of the memorandum of association will already be created through the online process, so all you would have to do is fill that out too.
- Registering online also means that you can register your company name with Companies House, register with HMRC for corporation tax and gain approval from the CIC regulator to form a CIC, all at the same time
- There is a filing fee for online incorporation for a CIC and that is £27
- Once approved, you will receive a certificate of incorporation via email. This is a confirmation that the company legally exists and shows the company number and date of formation.
- If registering through the post you will need to complete the form IN01, which is the application to register a company and form CIC36. You will also need to create the constitutional documents of a memorandum of association and articles of association.

Complete form IN01 - application to register a company

- Register a private or public company (IN01) - GOV.UK (www.gov.uk)
- Make sure that at the end of the company it is CIC or community interest company and not Ltd

Complete form CIC36 or community interest statement

- Just like form CIC37, in this form you indicate how the proposed activities of your CIC will benefit the community or a section of the community. You also have to explain how you think your company will be different from a commercial company providing similar services or products for individual or personal gain. This form will be sent to the community interest companies regulator who are the ones who decide whether the proposed company is eligible to become a community interest company.
- See: CIC36: application to form a community interest company - GOV.UK (www.gov.uk)

Create a memorandum and articles of association:

- As part of the formation of a CIC, a memorandum of association and articles of association are required.
- The articles are the rules or the constitution of the company, detailing the rules for the management and organisation of the company. All shareholders of the company (including any investors) are automatically bound by the articles when they become a shareholder.
- The memorandum is a legal document that is signed by all initial shareholders at the time of registration agreeing to form the company
- The difference between the memorandum and articles of association for CIC is that there are specific clauses that must be included into these documents as they are only applicable to CIC's. If you use the model documents that are on the gov.uk website they are underlined red and cannot be removed or altered.
- See: Community interest companies: model constitutions - GOV.UK (www.gov.uk)

Finally, send the documents and pay the fee

- Post the documents to the Registrar of Companies, with a cheque for £35 made payable to Companies House

Community Interest Companies (CIC)	
Advantages	Disadvantages

- Inexpensive and easy to set up
    - Companies House and CIC Regulator
- Access to certain forms of finance
- Limited Liability and Protection- less risk
    - Personal possessions are not at risk in case of business' failure
- Flexibility
    - Limited by guarantee
    - Limited by shares- ability to raise capital, employ multiple share classes, and pay dividends up to a 'dividend cap'
	- Lack of tax breaks available
	    - Possibility of a loss of personal income and social change income
	- Restrictions on dividends
	    - Only 35% of a CIC's distributable profits
	    - Inefficient in the cases where business focuses more on commercial purposes
	- Restrictions on the use of assets
	    - 'Asset lock'- assets in the CIC must be committed towards benefiting the chosen community
	- Impossible to convert to an ordinary company
	    - The founder will have to dissolve a CIC altogether or convert the company into a charity