



Lime One

FORMING A COMPANY IN ENGLAND & WALES

Relevant Law

Companies Act 1985
Companies Act 1985

WHAT IS A COMPANY?

A Company is an independent legal body with its own legal identity which stands of its own right and is created by incorporation at Companies House. On incorporation, the Company gets its own identity, complete with a Company registration number. Since it has its own legal identity a Company can, in its own name, undertake such activities as buying property, entering into contracts, and litigation in the Company name. The profits, losses, assets and liabilities belong to the Company.

WHAT ARE ARTICLES AND A MEMORANDUM?

When a Company is formed in England & Wales, it needs its own constitution to regulate the shareholder's rights and the Company powers. The constitution is made up of:-

- **Memorandum of Association** - deals with name, location, objects of the Company, contains a statement as the liability of its members and details of its share capital and the shareholders' names
- **Articles of Association** - deals with the Company rules for internal regulation and management, including the Director's powers.

The introduction of the Companies Act 2006 (currently this will be from October 2008) sees the availability of simpler "model frameworks" to make things easier for private companies when starting out.

WHO HAS AN INTEREST IN THE COMPANY?

- **Shareholders**- who are also known as members, make investment into the Company by buying shares in it and as such have a financial interest in it and there are to members because of that shareholding. Rules relating to shareholders are quite complicated but a private Company can not just have one shareholder.
- **Shares** - The number of shares that can be issued in a Company is limited by the authorised capital, although this can be raised at any time and to any level, subject to agreement of

the members. There is no set formula for how many shares to issue, save that at least one share must be issued on incorporation. In practice, this is usually quite easy since the shareholding of a Company determines its interest and “ownership”. Naturally, the more shares a person holds, the greater their rights are. For example, generally a holding of more than 50% of the issued shares in a Company will be sufficient to control the Company, determine the Board of Directors and the day to day running of the Company.

WHO RUNS THE COMPANY?

- **Directors** - are person appointed by shareholders, or on their behalf, to run the Company. A Company must have at least one Director but there is no legal limit as to how many Director's there can b, subject to the Company's own rules which it has set and may state minimum and maximum numbers of Directors. Directors effectively deal with the day to day running of the Company. The introduction of the Companies Act 2006 sees the setting out of a statutory statement of directors' general duties, including a duty to
 - promote the success of a Company,
 - to exercise independent judgment
 - exercise reasonable care, skill and diligence
 - avoid conflicts of interest
 - act within their powers

and a duty NOT to accept benefits from third parties

In addition, the new Companies Act now allows shareholders to sue Directors for negligence and other “defaults”.

- **Company Secretary**- deals with ensuring that the company complies with its legal and regulatory requirements by completing documents, keeps board members advised and informed as to legal responsibilities, and deals with the administration of calling meetings and ensuring implementation of decisions. Provided that there are at least 2 Directors, one of those Directors can also be the Company Secretary. However, upon full implementation of the Companies Act 2006 (currently this will be April 2008), a private Company will no longer need to have a Company Secretary

The introduction of the Companies Act 2006 simplifies decision-making processes in private companies and removes a statutory requirement of holding Annual General Meeting (AGM) and makes it to take decisions by written resolutions

ARE THERE DIFFERENT TYPES OF COMPANY?

There are 4 main types of Company

1 Private Company limited by shares - this means that a members' liability is limited to the amount unpaid for any shares they hold.

2 Public limited Company - this means that the Company offers its shares for sale to members of the general public, but like the private Company limited by shares, again a member's liability is limited to the amount unpaid for any shares they hold.

3 Private Company limited by guarantee - this means that a member's liability is limited to the amount they have agreed (guaranteed) to pay as a contribution if the Company is “wound up” (brought to a close, such as on liquidation when a Company is unable to pay its debts).

4 Private unlimited Company - this means that there is no limit to a member's liability

HOW DO I FORM A COMPANY?

The introduction of the Companies Act 2006 (currently this will be from October 2008) will see some changes with Company formation so this article will deal with the position until that date. A Company can be formed by submitting the following documents to Companies House

- Memorandum of Association
- Articles of Association
- Form detailing information regarding the first Directors, Company Secretary and Registered Office details
- A declaration confirming compliance with legislation relating to the current Companies Act.

Companies House will then register the Company and allocate the Company registration number.

Once the Company is registered there are, quite naturally, a number of other legal obligations which include:-

- Advising HMRC (for Tax, and where applicable, Employer and VAT purposes)
- Displaying the Company's name at its premises
- Displaying the Company's name, place of registration, registered number and registered office address on stationery and communication.

WHY FORM A COMPANY?

Such an important decision as to the legal structure of an organisation can not be taken lightly and legal advice should always be sought. However, there are a number of benefits to forming a Company, which include

Limited liability - this is often considered the main benefit to structuring a business as a Company, although this is changed somewhat since the advent of Limited Liability Partnerships (LLP). Liability limitation is important when a Company is wound up. As we have already explored, with a Private Company a member's liability is limited to the amount unpaid for any shares they hold (if limited by shares) or to the amount they have agreed (guaranteed) to pay as a contribution on winding up (if limited by guarantee). Likewise, shareholders are only liable for the amount of any unpaid shares. In practice, most shares are paid for when issued. For the difference regarding liability for Sole Traders and Partnerships, please see the following section. However, it should be noted that, with small Companies, banks often try and get around this limitation in liability by obtaining personal guarantees from Directors/Shareholders, including legal charges on private houses, so beware!

Tax - tax benefits, include on reinvestment and the ability to issue tax-free benefits to shareholders by paying dividends. Additional previous benefits for very small Companies have included the first £10,000 of profits being not subject to tax but this is not applicable on current legislation, but of course, such legislation changes so you must be sure of the current position when reaching a decision about structuring a business.

Perceived Respectability - this is often a perceived comfort with the ability to work behind the Company structure, with the guarantee of perpetual succession.

Share "ownership burden" - this can be spread widely by issuing shares to shareholders

However, some **disadvantages** include

Administration - there is a higher administrative burden for compliance for Companies than with alternative methods of running a business

Accounting - Annual Accounts must comply with the requirements of the current Companies Act and be filed with Companies House and so are on public view, although a statutory audit is often not required for small companies.

PAYE Tax - Directors are employed by the company and so salary is subject to PAYE

Trading Losses - individuals have more flexibility to deal with trading losses

Director's Liability - Company directors are more at risk of both criminal and civil penalty proceedings, such as by failing to submit accounts on time. Please also see above for forthcoming changes structuring Director's duties with the 2006 Act.

Capital Gains - Companies pay tax on capital gains at their corporation tax rate

OTHER ALTERNATIVE TYPES OF BUSINESSES?

Although each and every business must be examined very carefully, taking into account all needs and requirements, we have listed some of the main points to take into consideration when looking at alternative ways of structuring a business, other than Company formation.

SOLE TRADER

Own "boss" - perhaps one of the best things about a sole trader is that you stand alone. Certain types of people prefer to lead a business alone.

Profits - a sole trader gets to keep all the profits.

Less administration - sole traders have to do the least reporting, particularly to the Government

Tax - self-employed people have to pay income tax at the personal rate.

Work-load intrusion - On the down side, there is no-one to share experiences with and so may mean intrusion into personal privacy, and practical problems, such as organizing sickness and holidays.

Bankruptcy - sole traders have unlimited liability so that creditors have access to all their personal assets, and, if assets are insufficient to meet liabilities, a sole trader could be declared bankrupt

PARTNERSHIP

Partnerships are formed less formally than Companies but even in the case of just 2 partners who are also friends, a Partnership Agreement (this is a legal document which sets out the terms of the partnership such as who can draw money and what happens upon illness and death etc) is always advised.

In smaller partnerships, many of the same benefits and disadvantages apply as to those we have listed for Sole Traders. However in a partnership which is not clearly structured and has no Partnership Agreement, one may partner to deal with a "difficult" partner, along with all their other business concerns.

Partners are "jointly and severally liable". Effectively, if you are in business with a partner and that partner causes concerns and problems (such as ordering partnership business goods you can't afford to pay for) then it becomes your problem. Taking this further, if you have assets and your partner does not, the "jointly and severally liable" may mean, for example, that you take on the whole burden of a debt.

LIMITED LIABILITY PARTNERSHIP (LLP)

This is often seen as the “real” alternative to structuring a business as a Company. This is a partnership, consisting of members, which is incorporated by registration at Companies House. Benefits include

Limited Liability - in much the same way as in a Company, a member’s liability is limited to in that the LLP itself takes responsibility for debts.

Management flexibility - however, unlike a company an LLP have much greater flexibility in that they can organise the running of their business, particularly the internal structure and tax arrangements in the same way as an ordinary partnership.

Disadvantages include

Disclosure - similar disclosure of accounts to a Company

Administration - LLPs have to file an annual return, notify Companies House of changes etc, in much the same way as a Company