LAW PUNDITS

COMMON TYPES OF BUSINESS STRUCTURES AND FORMS

Course Material

COMMON TYPES OF BUSINESS STRUCTURES AND FORMS

It is important that the most appropriate form of vehicle is chosen to carry on a business—the choice of vehicle may have a bearing on the business's success or failure.

There is not one vehicle that will suit the needs and demands of every business. Each vehicle has its advantages and disadvantages. The decision as to which vehicle to use to carry on a particular business will be complex and is dependent on various legal, tax and commercial considerations—there may not be a perfect fit.

In addition, the vehicle originally chosen to carry on a particular business may not continue to be the right choice for that business as it develops and matures. The vehicle chosen to carry on a business should be kept under periodic review. If the original choice of vehicle to carry on a business becomes inappropriate, an alternative vehicle may take over that business, although a change of vehicle may be costly, depending on the circumstances.

Among the most common forms of vehicle used to carry on business in England and Wales are:

1. a sole trader
2. a partnership
3. a limited partnership, and
4. a limited liability partnership
5. a Company **- limited by shares**
6. a Company **- limited by guarantee**
7. an unlimited company

There are other forms of vehicle available to carry on business in several jurisdictions—the more unusual forms of vehicle include an unincorporated association, a community interest company, a European Economic Interest Grouping, a European company and an unregistered company.

Sole trader (also called sole proprietor)

A sole trader is a person carrying on business in his personal capacity.

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The main advantages of carrying on a business as a sole trader are that a sole trader has:

1. • to comply with few formalities in order to carry on his business as a sole trader
2. • complete control over the management of his business, and
3. •no obligation to publicly disclose any information

However, the main disadvantage is that, because a sole trader is acting in his personal capacity, he does not benefit from limited liability. He is personally liable for all the debts and obligations of the business.

General partnership

A partnership is the 'relation that subsists between two or more persons carrying on business in common with a view of profit' and is also referred to as a ‘firm’. A charitable or not-for-profit organisation cannot be a partnership.

A partnership is not a separate entity, distinct from its partners.

There is no public register of partnerships, although certain changes in a partnership's constitution must be notified in the *Gazette*.

Although the Partnership Act 1890 forms the basis of partnership law:

1. •it is not a complete code as the PA 1890 preserves all equitable and common law principles applicable to partnerships, except so far as they are inconsistent with its express provisions, and
2. • it is, on the whole, a voluntary code as a number of its provisions will apply to a partnership only in the absence of an agreement to the contrary between the partners

In practice, partners in a partnership will usually enter into a written agreement that will disapply the voluntary provisions of the PA 1890 that are not relevant to it and will govern the partnership's operation in conjunction with any applicable statutory provisions and rules of common law and equity.

The main advantages of carrying on business through a partnership are that:

1. •the partners have the flexibility to choose the management structure of the partnership by agreement, and

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2. •the partnership agreement (if any) does not have to be publicly disclosed
3. •the partnership's financial information is not required to be publicly disclosed, except in very limited circumstances

However, the main disadvantage is that each partner is jointly liable for the debts and obligations of the partnership incurred while he is a partner and such liability is potentially unlimited. After his death, a partner's estate may also have some liability for such debts and obligations.

A partnership is often used as a trading vehicle and by the professions.

Limited partnership

A limited partnership (an **LP**) is formed under the Limited Partnership Act 1907 (**LPA 1907**).

An LP consists of:

1. •at least one 'general partner', who shall be liable for all the debts and obligations of the LP (although, in practice, the general partner is normally a limited company (as defined))
2. •at least one 'limited partner', who shall:
    1. ◦at the time of entering into the LP contribute to it a sum or sums as capital or property
    2. ◦ not be liable for the debts and obligations of the LP beyond the amount contributed by such limited partner

An LP is not a separate entity distinct from its partners.

An LP is formed by registration at Companies House and it is necessary to notify certain changes in the information registered in relation to an LP to Companies House. In addition, certain transactions and arrangements must be notified in the *Gazette*.

In practice, partners in an LP will usually enter into a written agreement that will disapply the voluntary provisions of the LPA 1907 and the PA 1890 that are not relevant to it and will govern the operation of the LP in conjunction with any applicable statutory provisions and rules of common law and equity.

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The main advantage of carrying on business through an LP is the limited liability of the limited partners (and, if the general partner is a limited company, in practice it can avoid unlimited liability as a general partner).

Another advantage is that, although some information relating to an LP must be disclosed to Companies House and in the *Gazette*, this is minimal, and it is not necessary to publicly disclose:

1. •the LP agreement (if any), or
2. •the LP's financial information, except in very limited circumstances

However, the disadvantages of carrying on business through an LP include the fact that a limited partner:

1. •must not take part in the management of the LP
2. •shall not have the power to bind the LP, and
3. •must not draw out, either directly or indirectly, any part of his contribution to the capital of the LP during its duration

If a limited partner takes part in the management of the LP, he shall be liable for all debts and obligations of the LP incurred while he so takes part in the management as though he were a general partner.

If a limited partner draws out, either directly or indirectly, any part of his contribution to the capital of the LP during its lifetime, he shall be liable for the debts and obligations of the LP up to the amount so drawn out or received back.

An LP is most likely to be suitable for the carrying on of a business where:

1. •a number of the partners do not intend to be involved in the management of the business, so are happy to be limited partners, and
2. •the LP is intended to deliver a specific project that is to be completed by a set date, which will enable the limited partners to recover their capital contribution within a certain period

LPs are commonly used as investment vehicles.

Limited liability partnership

A limited liability partnership (an **LLP**) is incorporated under the Limited Liability Partnerships Act 2000 (**LLPA 2000**).

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It must be incorporated at Companies House by two or more persons associated for carrying on a lawful business with a view to profit.

An LLP is a body corporate that is a separate legal entity from its members (sometimes referred to as 'partners').

There are two or more 'designated members' of an LLP who are designated either on incorporation or by and in accordance with an agreement with the other members. A member may cease to be a designated member in accordance with an agreement with the other members.

If less than two members are expressly designated, then every member is deemed to be a designated member.

Any designated members have administrative responsibilities in relation to an LLP, eg, notifying certain matters to Companies House.

It is necessary for an LLP to make public disclosures through filings at Companies House similar to those that apply to a company, eg, it must register charges and mortgages, file accounts and an annual return and notify any changes in its name, registered office and members.

Except as otherwise provided by the LLPA 2000 or any other enactment, the law relating to partnerships does not apply to an LLP.

However, an LLP is subject to many of the statutory requirements that apply to companies and many of the statutory requirements relating to corporate insolvency and winding up pursuant to various sets of regulations made under the LLPA 2000.

In addition, except as otherwise provided by the LLPA 2000 or any other enactment, there are a number of the default provisions set out in the Limited Liability Partnerships Regulations 2001 (the **LLP Regs 2001**) that will apply as between the members and as between the members and an LLP:

1. •in the absence of an agreement to the contrary between them, and
2. •subject to the general law

The LLP Regs 2001 also provide that no majority of the members can expel any member unless a power to do so has been conferred by express agreement between the members.

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In practice, members of an LLP will usually enter into a written agreement that will disapply any default provisions that are not relevant to the particular LLP and will govern the operation of the LLP, in conjunction with any applicable statutory provisions and general law.

If an LLP is wound up, a member's liability to contribute is limited to the amount that the member has agreed with the other members or with the LLP that he will contribute.

The main advantage of carrying on business through an LLP is the limited liability of the members for the debts and obligations of the LLP.

One of the main disadvantages of carrying on business through an LLP is the significant level of public disclosure such companies are required to make through filings at Companies House. However, it is not necessary to publicly disclose the LLP agreement (if any).

LLPs are popular vehicles for use by the professions, such as solicitors and accountants.

The next most common forms of vehicle used to carry on business in England and Wales include various forms of company, the most common being:

1. • a company limited by shares
2. •a company limited by guarantee, and
3. •an unlimited company

Company

A company (as defined) is a separate legal entity, distinct from its members (as defined).
It is owned by its members and it is managed by its directors. It is regulated by the Companies Act 2006 (CA 2006).

A company can appear more stable than other vehicles for carrying on business, so may seem more attractive to investors, suppliers and customers.

Company limited by shares

A company is a company limited by shares if the liability of its members (commonly referred to as 'shareholders') is limited by its constitution to the amount unpaid, if any, on the shares held by them and this is all that the shareholders are obliged to contribute to the company's assets. The limited liability of its shareholders is the main advantage of carrying on business through a company limited by shares.

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One of the main disadvantages of carrying on business through a company limited by shares is the level of public disclosure such companies are required to make through filings at Companies House, eg, it must register charges and mortgages, file accounts and an annual return and notify changes in its name and registered office. In addition, the constitutional documents of a company limited by shares, ie, its memorandum and articles of association, must be filed at Companies House and are publicly available.

However, there may be other advantages and disadvantages, depending on whether the company limited by shares is a private company (as defined) or a public company (as defined).

Private company limited by shares:

A private company limited by shares is subject to some regulation and requires a moderate level of administration. However, its structure is such that it can be used easily as a vehicle for smaller businesses as well as larger ones, which may be viewed as an advantage.

A private company limited by shares, eg:

1. • need only have one director (although if it does have a sole director, that sole director must be a natural person, as a company must have at least one director who is a natural person)

2. • does not need to have a company secretary, unless its articles of association require it to have one (and if it does have a company secretary, that person is not required to have any particular qualifications)

3. • is not required to hold an annual general meeting each year unless:

    - its articles of association require it to have one, or

    - it is a traded company (as defined), but this would be very unusual, and

    - can use the written resolution procedure to pass resolutions of its shareholders (subject to certain statutory exceptions), rather than needing to pass shareholder resolutions at general meetings of its shareholders

However, one significant limitation on a private company limited by shares is that it cannot (except in very narrow circumstances):

1. • offer its shares or debentures to the public, or

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2. • allot or agree to allot any shares or debentures with a view to their being offered to the public

Therefore, it cannot raise capital on the equity capital markets, which may make this an unattractive vehicle for some businesses.

A private company limited by shares is the most common form of vehicle used to carry on business, often used as a trading vehicle and as a vehicle for joint ventures.

Public company limited by shares:

The main advantage of carrying on business through a public company limited by shares is that it can:

1. • offer its shares and debentures to the public, and

2. • allot or agree to allot any shares or debentures with a view to their being offered to the public

This means that it has the ability to raise capital on the equity capital markets. However, it does not have to do so.

However, a disadvantage of carrying on business through a public company limited by shares is that it is subject to a higher level of regulation and requires more administration than a private company limited by shares (and other types of company).

For example, a public company limited by shares:

1. • must obtain a trading certificate before it can carry on business or exercise any borrowing powers

2. • must have a minimum issued share capital of £50,000 or the prescribed Euro equivalent (currently €57,100), of which at least a quarter of the nominal value of the share capital and the whole of any premium must be paid up

3. • must have at least two directors (at least one of whom must be a natural person)

4. • must have a company secretary (who must have the requisite knowledge and experience to be the company secretary and have certain specified qualifications)

5. • must hold an annual general meeting each year, and

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6. • is not permitted to use the written resolution procedure to pass resolutions of its shareholders, so must hold general meetings of its shareholders to pass shareholder resolutions

A public company limited by shares is a common form of vehicle used for carrying on business, often used as a trading vehicle. The use of a public company limited by shares is sometimes felt to provide more kudos to a business than the use of a private company limited by shares.

Company limited by guarantee

A company is a company limited by guarantee if the liability of its members is limited by its constitution to such amount as the members undertake to contribute to the assets of the company in the event of its being wound up.

The amount that members undertake to contribute to these assets in the event of its being wound up is usually a nominal sum.

The limited liability of its members is the main advantage of carrying on business through a company limited by guarantee.

It is not possible for a company limited by guarantee to be a public company. There is a different type of company, a company limited by guarantee and having a share capital, that can be either a public company or a private company, but it has not been possible to form such a company (or re-register as such a company) since 22 December 1980 in Great Britain and since 1 July 1983 in Northern Ireland.

One of the main disadvantages of carrying on business through a company limited by guarantee is the level of public disclosure such companies are required to make through filings at Companies House, eg, it must register charges and mortgages, file accounts and an annual return and notify changes in its name and registered office. In addition, the constitutional documents of a company limited by guarantee, ie, its memorandum and articles of association, must be filed at Companies House and are therefore publicly available.

A private company limited by guarantee is subject to some regulation and requires a moderate level of administration. However, its structure is such that it can be used easily as a vehicle for smaller businesses as well as larger ones, which may be viewed as an advantage.

For example, a private company limited by guarantee:

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1. • need only have one director (although if it does have a sole director, that sole director must be a natural person, as a company must have at least one director who is a natural person)

2. •does not need to have a company secretary, unless its articles of association require it to have one (and if it does have a company secretary, that person is not required to have any particular qualifications)

3. •is not required to hold an annual general meeting each year, unless its articles of association require it to have one, and

4. •can use the written resolution procedure to pass resolutions of its shareholders (subject to certain statutory exceptions), rather than needing to pass shareholder resolutions at general meetings of its shareholders

A company limited by guarantee is most commonly used by not-for-profit organisations, such as charities, clubs, associations and societies that would like their members to benefit from limited liability.

Unlimited company

A company is an unlimited company if there is no limit on the liability of its members. The unlimited liability of its members is the main disadvantage of carrying on business through an unlimited company.

It is not possible for an unlimited company to be a public company.

An unlimited company may have a share capital or it may not.

The level of public disclosure that an unlimited company is required to make through filings at Companies House may be seen as a disadvantage of carrying on business through this form of company, eg, it must register charges and mortgages, file an annual return and notify changes in the company's name and registered office. In addition, the constitutional documents of an unlimited company, ie, its memorandum and articles of association, must be filed at Companies House and are therefore publicly available.

However, the level of public disclosure that an unlimited company must make through filings at Companies House is not as high as the level of public disclosure that must be made by other forms of company. An unlimited company:

1. • does not have to file accounts and reports if certain conditions are met, and
2. •does not have to file returns of allotments of shares (unless the directors allot a new class of shares)

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In particular, the possibility of keeping its accounts and reports private might be seen as an advantage of carrying on business through an unlimited company.

An unlimited company is subject to less regulation than other types of company and it requires less administration. In addition, its structure is such that it can be used easily as a vehicle for smaller businesses as well as larger ones, which may be viewed as an advantage.

For example, an unlimited company:

1. • need only have one director (although if it does have a sole director, that sole director must be a natural person, as a company must have at least one director who is a natural person)

2. • does not need to have a company secretary, unless its articles of association require it to have one (and if it does have a company secretary, that person is not required to have any particular qualifications)

3. • is not required to hold an annual general meeting each year, unless its articles of association require it to have one, and

4. • can use the written resolution procedure to pass resolutions of its shareholders (subject to certain statutory exceptions), rather than needing to pass shareholder resolutions at general meetings of its shareholders

In addition, an unlimited company is not subject to the usual maintenance of capital rules, eg, it has the power to purchase its own shares and is not subject to the statutory restrictions that apply to a limited company wishing to purchase its own shares.

Historically, a key reason for carrying on business through an unlimited company was that it was possible to reduce its capital without going through the complex court-based reduction of capital procedure that applied to limited companies. However, since 1 October 2008, there has been a simpler solvency statement procedure in place that may be used by private companies limited by shares to reduce their capital, so the use of an unlimited company may become less common.

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