

Suite 108**SELECTING A COMPANY STRUCTURE*****Selecting the right legal structure******Self employment - Partnerships******Corporate Entities******The Franchise******The Trust******Special Structures******Overseas or Offshore Companies*****108.01 TYPES OF BUSINESS STRUCTURE**

In the private sector of Western Countries there are basically seven main ways of owning a business (although their designations may vary).

These are:

- Self Employed; Sole Proprietor, Sole Trader
- Partnerships
- Limited Liability Partnerships (LLP)
- Franchises
- Corporations, Limited Liability Companies, Proprietary Limited
- Public Companies / Public Limited Companies
- Co-operatives

You will need to decide which legal form of business is best for you prior to your first sales or before you begin trading. Your final decision will set your legal structure, the way in which you will be taxed and the accounting records you will have to keep.

Even with a simple business where you are going to work from home you might take advice on any advantages in forming a limited liability company or partnership.

Can your business structure place your family assets in a position of liability? If one of your employees were injured can the person sue you and take your home and savings? Is there a better business structure with regard to taxable income? These questions can easily be overlooked, yet the answers depend on the business' legal structure. Even if you've been operating for some time it is never too late to change to the best legal structure for your situation. You may find that your new business structure may affect your purchasing strategy and even your selling price.

To double check the exact definition and requirements for a type of business in **Canada**, you can check with each Province individually at:

<http://bsa.cbcs.org/glo/bsainterface.nsf/vSSGBasic/su10000e.htm>

SELECTING THE RIGHT LEGAL STRUCTURE

108.02 SOLE PROPRIETOR OR SOLE TRADER

This is the easiest and least costly way of starting a business the most straightforward structure for a business. Under a sole proprietorship, the business is owned in an individual capacity this means that the business decisions are being made by one person or a marital community. The assets are held in the name of the owner, individual or individuals who own the business.

You only need to register as self-employed. If your business fails, then you are fully responsible for all the business's debts. All decisions are made by the owner. You will normally rely on your own personal money. Strict accounting or audit requirements are not required, with the exception to a tax audit. Records are not available for public inspection. All profits belong to the owner. With regard to tax: under a self-employed status: profits, drawn or not, are taxed as income, possibly at a higher rate. Usually tax deductible pension contributions are restricted. Losses can be offset against tax on other income. Should the owner die or retire, the business may go out of existence. If the business is to be sold, usually the whole business has to be sold. It is difficult to sell just a part of it.

Options to raise finance are usually more available through traditional methods such as overdrafts and loans. If you are trading under a name different from that of the owner(s), you must display the name and address of the owner(s) at the premises and on the stationary.

A sole trader pays tax in their own right, as part of their personal income tax return at the personal rate of income tax.

Seek legal advice to cover unforeseen circumstances; such as, divorce or if your spouse dies. Enquire if you may be able to protect the family home from being exposed if it is in the name of your spouse.

Key disadvantages are: lack of support, unlimited liability and you are personally responsible for any debts run up by your business.

108.03 PARTNERSHIP

Partnerships are relatively inexpensive to form. It requires an agreement between two or more individuals or entities to jointly own and operate a business. Each partner brings his own valued experience and skills which when added together makes the partnership that much stronger. All the partners remain equal from a legal point of view if there is no written agreement, all partners: share profits equally, cover losses equally, take equal responsibility for the business's activities and trading.

A written agreement allows partners to change these general rules and records them in the agreement. It can be simply an oral agreement between the persons, but a legal partnership agreement drawn up by an attorney is highly recommended. This could be a source of solving any dispute arising from one or more of the partner's business actions. The proper legal procedure is to draw up a 'deed of partnership'. This may not be required by law but is useful to solve disputes. (Seek legal advice as this can change from country to country).

The 'deed of partnership' may contain details of how the profits will be shared. The profits drawn or not, are taxed as income, and quite possibly at a higher rate. Tax deductible pension contributions are restricted. Normally losses can be offset against tax on other income. Under normal conditions a partnership is 'dissolved' if one of the partners dies, resigns or becomes bankrupt. Again these issues can be addressed within the 'deed of partnership'.

The partners will still have unlimited liability. If the business fails, you will be liable for your own and partner's business debts. The Partners will share the responsibility for controlling the business. The funding of the partnership will rely on the partners' finances or their combined ability to secure capital. Except for taxes there are no strict accounting or audit requirements. The company's records are not open for public inspection. The profits are shared by the partners.

Short term partnerships are also known as joint ventures.

A Partnership Agreement should include:

- type of business
- equity invested by each partner
- division of profit or loss
- partners compensation
- distribution of assets on dissolution
- duration
- dispute settlement clause provisions for changes or dissolving the partnership
- restrictions of authority and expenditures
- settlement in case of death or incapacitation
- rights of departing partners to start a similar business, etc.
- how a partner can leave the partnership and the consequences of this
- requirements to provide financial reports
- rights of partners to draw on bank accounts.

Should a partner do something that is outside their authority under the partnership agreement; how would this legally affect the partnership? This depends whether the person who dealt with the partner knew (or should have known) the action was beyond their authority. But even if this is so, it will sometimes still be possible for the person to claim compensation from the partnership. The lesson is clear: be very careful who you accept into a business partnership.

108.04 LIMITED PARTNERSHIP (LP)

LPs have complex formation requirements, and require at least one general partner who is fully responsible for partnership obligations and normal business operations. The LP also requires at least one limited partner, often an investor, who is not involved in everyday operations and is shielded from liability for partnership obligations beyond the amount of their investment. LPs do not pay tax, but must file a return for informational purposes; partners report their share of profits and losses on their personal returns.

108.05 LIMITED LIABILITY PARTNERSHIP (LLP)

A Limited Liability Partnership or LLP is exactly what it sounds like it is organized to protect individual partners from personal liability from the negligent acts of other partners or employees not under their direct control. It is therefore considered advantageous for small businesses due to the limited personal liability feature similar to that of a corporation but with the tax advantage of a partnership or sole proprietorship. In that, profits and losses can be passed through the company to the individual partners or the LLC can elect to be taxed in a manner similar to a corporation.

The LLC is not required to observe corporate formalities since they do not issue stock. Instead of having stockholders the owners are called members and the entity is either managed by the members or by an employed manager.

The primary advantage is that personal liability is limited. The flexibility of the partnership is retained as opposed to the structure of a limited company. There are no restrictions on the number of members within the LLC, but a minimum of two must be "designated members". The two "designated members" will have extra responsibilities as required by law.

Formation expenses are more costly than that of a partnership. Particular attention should be addressed to the prevention of problems which could result from disagreements between members. Should the partnership reduce to less than two designated members then every member is deemed to be a designated member.

In the **United States** LLPs are not recognized by every state. In most states that do recognize this structure they are mostly limited to those providing professional service, such as medicine or law, for which each partner is licensed. Each Partner is required to report their share of profits and losses on their personal tax returns. If you are considering this type of structure check with your Secretary of State's office to see if your state recognizes LLPs and if so, which occupations qualify.

Specific to the **United Kingdom**. If you decide to form a Limited Liability Partnership, you need to know about the rules and regulations explained in the 2 guidance note booklets, available from Companies House:

- 'Limited Liability Partnerships Formation and Names'
- 'Limited Liability Partnerships Administration and Management'

Send form LP5 to Companies House, including details of name selected, which must not clash with any existing limited company, where office is, how long the partnership is intended to last, name of one general partner, and one limited partner – enabling Companies House to issue the certificate.

Having a formal deed of partnership drawn is optional. If you intend trading under a name different from that of owner(s), you must display the name and address of owner(s) at premises and on stationary.

If the LLP has 2 members and one dies, another must be appointed within 6 months. This is because the law recognises an LLP as a 'separate legal entity' (there must be members – and cannot be just one person).

CORPORATE ENTITIES

108.06 A CORPORATION OR LIMITED LIABILITY COMPANY

In the **United States** and **Canada** referred to primarily as Corporations, in the **United Kingdom** and **Ireland** companies with Limited Liability or LTD, in both **Australia** and **New Zealand** companies are formed under Commonwealth law called the Corporations Act. They are referred to as Companies with the designation of either Ltd, or Pty (Proprietary Limited) following their name. In these cases the liability is usually limited for the shareholders (unless they have given a personal guarantee).

This type of company structure has 'perpetual existence'. This is because the law recognizes a company as a separate legal entity (the owners and the company are not considered one and the same).

This is a complex business structure with more start-up costs than many other forms. This brings a range of extra legal duties, including the maintenance of the company's public records e.g. filing of accounts. It may be incorporated without an attorney, but legal advice is highly recommended. Control depends on stock ownership. Persons with control of stock shares or a group whose stock shares are over 51% will control the corporation and are able to make policy decisions. Control is exercised through regular shareholder meetings and annual stockholders' meetings. Records must be kept to document decisions made by the board of directors. A corporation is a legal entity separate from its owners, who own shares of stock in the company. It can be created for profit or non profit purposes, and may be subject to increased licensing fees and more government regulation than other forms. Profits are taxed both at the corporate level and again when distributed to shareholders.

Shareholders are not personally liable for corporate obligations unless corporate formalities have not been observed. Officers of a corporation can be liable to stockholders but liability is generally limited to stock ownership, except where fraud is involved. Observing such formalities provides evidence that the corporation is a separate legal entity from its shareholders. Failure to do so may open up the shareholders to liability of the corporation's debts. Corporate formalities include:

- Issuing stock certificates
- Holding annual meetings
- Recording the minutes of the meetings
- Electing directors or ratifying the status of existing directors

Corporations should always be assisted by a qualified attorney.

The company would be required to legally register with either with the State or with the Registrar of Companies. All filing fees must be paid up. To register as a 'company' you normally must provide three documents: a memorandum of association, articles of association and a statutory declaration.

Normally, liability is limited up to a maximum of the capitalization of the company. The shareholders' personal assets are protected if the business gets into financial trouble. Therefore, you would only lose the money you have put into the business.

The management of the company would be the responsibility of the Board of Directors and Management hired to control the business. It is not necessary for all the shareholders to take an active part in running the business. Capital is raised by the issuance of shares. Although this provides a limited company with permanent capital, the shares cannot be offered for sale to the general public. Accounting and audit requirements apply. Accounts must be open for public inspection. In some countries, such as the United Kingdom, annual accounts must be sent to the Registrar of Companies. Dividends may be paid to shareholders. The Dividends are declared by the Board of Directors, but profits may be kept to expand the business. There will be corporate tax on company profits. And, losses would be retained in the company.

Employee status could mean, higher Pension and Health insurance, but with full benefits. You may make unlimited contributions to a company pension.

If you decide to form a limited company within the **United Kingdom**, you need to know about the rules and regulations explained in the booklet 'Company Names – Guidance Notes'. Once you have agreed a name and have registered the name and office with Registrar of Companies (Companies House). A solicitor is required to swear a statutory form of incorporation. There are specific laws requiring the display of certain information at the registered office, these must be adhered to.

In **Australia** and **New Zealand** companies no longer require a memorandum and articles of association; instead they may have a set of rules called a "constitution" which sets out the objects of the company. Which does not have to be lodged with the application for registration but must be kept with the company's records; or depend on the rules of internal management – these are called "replaceable rules" because they can be replaced in whole or part by a constitution. The replaceable rules do not apply to private companies with a single member who is also the sole director.

Australia:

http://www.australia-migration.com/page/Companies_what_is_a_company/137

United Kingdom:

<http://www.businesslink.gov.uk/>

www.companies-house.gov.uk

108.07 LIMITED LIABILITY CORPORATION (LLC)

A Limited Liability Corporation or LLC is exactly what it sounds like it because it combines the limited personal liability feature of a corporation with the tax advantage of a partnership or sole proprietorship it is considered advantageous for small business. Profits and losses can be passed through the company to its members, or the LLC can elect to be taxed like a corporation. The LLC does not have stock, and are not required to observe corporate formalities. Owners are called members, and the LLC is managed by these members or by appointed manager.

This is a complex business structure with more start-up costs than many other forms. A corporation is a legal entity separate from its owners, who own shares of stock in the company. It can be created for profit or non-profit purposes, and may be subject to increased licensing fees and more government regulation than other forms.

You would be required to legally register the company either with the State or with a Registrar of Companies. All filing fees must be paid up. To register as a 'company' you normally must provide three documents: a memorandum of association, articles of association and a statutory declaration. You would have limited financial liability. For an LLP you must provide an incorporation document and a statement of compliance.

Normally you would be liable up to a maximum of the capitalization of the company. The shareholders' personal assets are protected if the business gets into financial trouble. You would only lose the money you have put into the business.

Shareholders are not personally liable for corporate obligations unless corporate formalities have not been observed. Observing such formalities provides evidence that the corporation is a separate legal entity from its shareholders. Failure to do so may open up the shareholders to liability of the corporation's debts.

Corporate formalities include:

- Issuing stock certificates
- Holding annual meetings
- Recording the minutes of the meetings
- Electing directors or ratifying the status of existing directors

Corporations should always be assisted by a qualified attorney.

The management of the company would be the responsibility of the Board of Directors and Management hired to control the business. It is not necessary for all the shareholders to take an active part in running the business. Capital is raised by the issuance of shares. Although this provides a limited company with permanent capital, the shares cannot be offered for sale to the general public. Accounting and audit requirements apply. Accounts must be open for public inspection. In some countries, such as the **United Kingdom**, annual accounts must be sent to the Registrar of Companies. Dividends may be paid to shareholders. The Dividends are declared by the Board of Directors, but profits may be kept to expand the business. Employee status could mean, higher Pension and Health insurance, but with full benefits. You may make unlimited contributions to a company pension. There will be corporate tax on company profits. And, losses would be retained in the company. This type of company structure has 'perpetual existence'. This is because the law recognizes a company as a separate legal entity' (the owners and the company are not considered one and the same).

108.08 PUBLIC COMPANIES OR PUBLIC LIMITED COMPANIES

Literally a public company is a company owned by the public. There are two uses of this term.

- A company that is owned by stockholders who are members of the general public and traded publicly. Ownership is open to anyone that has the money and inclination to buy shares in the company. It is differentiated from privately held companies where the shares are held by a small group of individuals often members of one or a small group of families or otherwise related individuals (or other companies).

- A company that is owned by a government body. This meaning of the words comes from the fact that government debt is sometimes referred to as “public debt”, and government finance, is sometimes called “public finance”. When a company is government owned this usually means that the company is guided by the state and that making profit is not its primary goal. Privatization is a trend related to “globalization” with the result that more and more government companies are being privatized. Many public companies are also monopolies.

Public companies and the responsibilities of the Directors and Officers as well as information regarding types of stock, and “Initial Public Offerings” will be covered under Operation of a Business and Business Expansion.

THE FRANCHISE

108.09 THE FRANCHISE

What is a Franchise? Well, franchise companies are based on buying the rights and support systems of a successful business created and established by someone else. It is very common way of starting into business.

The Franchiser may establish outlets in many other locations. Each location would use the same company name, operating system, purchasing procedures and management system, as well as benefiting from general advertising campaigns. The degree and type of support from outlet to outlet can vary.

Buying a franchise takes advantage of the success of an established business and tested support networks. Your freedom to manage the business is limited by the terms of the franchise agreement. Franchisees often pay a share of their turnover to the franchiser, which brings down their overall profits. This is an easy way to start a business, but be aware that it can have some serious pitfalls.

In **Australia** franchises are bound by the Franchising Code of Conduct which requires franchisors to disclose specific information and follow certain rules. When buying, extending or renewing a franchise, or with resolving disputes help and assistance may also be available from state and territory governments. Contact the Small Business Development Corporation for information and guidance from a specialist who can help you evaluate a franchising opportunity before making any binding commitment.

SPECIAL STRUCTURES

The following business structures are available in some (States, US), but not all. Use the Country Profile Sector, Special Report on the United States, go to 50 Sovereign States, then select the State and look under Business Information.

108.10 SUB CHAPTER S CORPORATION (INC. OR LTD.)

This is identical to the C Corporation in many ways, but offers avoidance of double taxation. First, you must seek qualification for "S" status with the Tax Authority; it is taxed like a partnership: the corporation is not taxed, but the income flows through to shareholders that report the income on their individual returns.

Rules and regulations affecting tax, National Insurance Contributions and pension premiums can be complicated and may change. You should always ask an accountant about such matters.

108.11 CO-OPERATIVES

Promoting bodies, there are 21, can provide model rules and can arrange application for registration under industrial and Provident Societies Act with the Registrar of Friendly Societies. Must satisfy Registrar that:

- 1) a genuine society
- 2) have at least 7 members
- 3) the proposed name is acceptable.

108.12 SOCIAL ENTERPRISES (United Kingdom)

A Social Enterprise will mainly focus on mutual support and training. The profits are invested in the enterprise or used to benefit the community. To maintain democratic decision making requires a high level of commitment from every member.

A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.

They are businesses distinguished by their social aims. Examples of social aims are job creation and training, providing community services and "fair trade" with developing countries. There are many different types of social enterprises, including community development trusts, housing associations, worker-owned co-operatives and leisure centres.

Social enterprises may take a number of different business structures – companies limited by guarantee, companies limited by shares and industrial and provident societies are the most usual.

Please note that from 2005, a new trading form, the Community Interest Company or CIC, will be introduced. This will provide social enterprises with the flexibility of the company form. Industrial and provident societies must register with the Financial Services Authority.

In most cases Social Enterprises will operate in a democratic manner with the "stakeholders" taking on the responsibilities of decision-making. This may include employees, end users and appointed trustees. Record keeping will depend on the structure of the social enterprise. The primary source of income will be from raising money similarly to any other business, but they may also secure grants and loans from public organisations. Profits are principally reinvested in order to meet their social objectives or to benefit the community. Taxation will also depend on the business structure of the enterprise. In some cases they may claim charitable status which will reduce the amount of tax payable.

Advantages include limited liability, allowing for income streaming, there may be taxation advantages – although this depends on current tax law. The disadvantages include; possible implication for capital gains tax, distribution of tax losses, establishment and administration costs.

108.13 THE PROFESSIONAL SERVICE CORPORATION (PS)

A PS must be organized for the sole purpose of providing a professional service for which each shareholder is licensed. The advantage here is limited personal liability for shareholders. This option is available to certain professionals, such as doctors, lawyers and accountants. Check with your Secretary of State's office to find out which occupations qualify.

108.14 NON-PROFIT CORPORATIONS

These are formed for civic, educational, charitable and religious purposes, and enjoy tax exempt status and limited personal liability. Non-profit corporations are managed by a board of directors or trustees. Assets must be transferred to another non-profit group if the corporation is dissolved.

THE TRUST

108.15 WHAT IS A TRUST

A trust is a relationship in which a person or entity (the trustee) has legal control over certain property (the trust property or trust corpus), but is bound to exercise that legal control for the benefit of someone else (the beneficiary).

The trustee can be either a natural or a legal entity. There can be multiple trustees, in which case the trust should provide a mechanism for the trustees to make decisions. A trust will not fall solely for want of a trustee; if there is no trustee, whoever has title to the trust property will be considered the trustee.

Types of Trust:

A Fixed Trust

In a fixed trust, the amount of money or other goods or services to be paid to the beneficiaries is fixed by the settler. An express fixed trust requires a certain degree of certainty regarding who are the beneficiaries and the amounts to be paid to them, so that the trustee has little or no discretion. If this degree of certainty is not met, an implied trust exists instead.

A Discretionary Trust

In a discretionary trust, the amount of money or other goods or services to be paid to the beneficiaries is up to the trustee, so long as the decision is made based on the beneficiary's best interests.

A Hybrid Trust

A hybrid trust combines elements of both fixed and discretionary trusts. In a hybrid trust, the trustee must pay a certain amount of the trust property to each beneficiary fixed by the settler. But the trustee has discretion as to how any remaining trust property, once these fixed amounts have been paid out, is to be paid to the beneficiaries.

A Unit Trust

A unit trust is a trust where the beneficiaries (called unit holders) each possess a certain share (called a unit holding) and can direct the trustee to pay money to them out of the trust property according to the number of unit holdings they possess. Unit trusts are primarily used for investment purposes.

A Protective Trust

A protective trust is a type of trust that was devised for use in estate planning. Often a person, 'A', wishes to leave property to another person 'B'. A however fears that the property might be claimed by creditors before A dies, and that therefore B would receive none of it. A could establish a trust with B as the beneficiary, but then A would not be entitled to use of the property before he died. Protective trusts were developed as a solution this situation. A would establish a trust with both A and B as beneficiaries, with the trustee instructed to allow A use of the property until they died, and thereafter to allow its use to B. The property is then safe from being claimed by A's creditors, at least as long as the debt was entered into after the trust's establishment. This use of a trust is similar to *life estates* and *remainders*, and is frequently used as an alternative.

Trusts are often used in connection with running a small business. A trust is not a separate legal entity in the same way that a company is. In simple terms it is a business structure where a trustee (usually a company) carries out the business on behalf of the members of the trust. A trust is set up through a trust deed. The Trustee is usually a company (it can be a person) which owns the assets of the trust, not in its own right, but as trustee of the trust. The trustee is responsible for the financial "health" of the trust and makes decisions about distributing income, borrowing money etc.

The Appointer or Protectorate is the person who has the power under the trust deed to remove the trustee and appoint another trustee.

108.16 CHARITABLE TRUST

A Charitable Trust (also called a public trust) has a charitable end as its beneficiary. In order to qualify as a charitable trust, the trust must have as its object certain purposes such as alleviating poverty, providing education, carrying out some religious purpose, etc. The permissible objects are generally set out in legislation, but objects not explicitly set out may also be an object of a charitable trust, by analogy. Charitable trusts are entitled to special treatment under the law of trusts and also the law of taxation.

OVERSEAS or OFFSHORE COMPANIES

108.17 WHAT ARE OVERSEAS or OFFSHORE COMPANIES?

The words offshore business and offshore company have no precise legal, tax or general business meaning, as the word offshore often means nothing more than anywhere other than the place of physical location of the person using the word (i.e. overseas).

Almost all countries offer tax regulations of one kind or another to encourage inward investment.

International tax advisers have long been aware of the opportunities which exist for improving overall tax efficiency by using the special low tax regimes offered by high tax countries seeking to encourage international business. However, successful implementation of such structures is dependent on a wide variety of issues, often relating to matters such as anti-avoidance provisions, double tax avoidance, controlled foreign company and management and control tests and provisions, transfer pricing, thin capitalisation, participation exemptions, capital gains tax and a myriad of other ever-changing tax regulation. More recently, the weapons contained in the armoury of the tax collectors have been supplemented by exchange of information treaties and provisions.

Today the offshore world includes the expert implementation of specific tax advantageous structures domiciled in high tax onshore countries as diverse as the UK, Portugal, Singapore, Greece, Belgium, Austria, Spain, Switzerland, Luxembourg and the Netherlands.

For more information on Offshore companies look under Business Expansion.