Suite 502

CORPORATIONS AND THE LAW

Corporations and the Law
Company Structure & Responsibilities
Shares and Shareholders
Offering Shares to the Public
Paying Dividends & Paying Tax

502.01 WHY HAVE A COMPANY?

Not all business are companies. The reasons for having a company can be complex, involving ownership of property, obtaining investment from a variety of sources, taxation or contractual relationships. Many businesses function satisfactorily as sole traders or partnerships.

The key point to recognise is that a company is a separate entity – a legal person in its own right, quite separate from those who own it (the members, usually shareholders) and those who run it (the directors). Many problems – and court cases – arise from people failing to recognise the difference between business people and the companies with which they are involved.

As a separate person, a company can itself:

- Own property
- Employ people
- Act as director or secretary of another company
- Enter into contracts
- Sue in the courts
- Be sued

Public companies

The key difference between public and private companies is that a public company may offer to sell its shares to the public. It may be quoted on the Stock Exchange or the Unlisted Securities Market, but does not have to be.

Different countries have different financial requirements placed on a public company prior to it being authorized to commence business and borrow money. In the United Kingdom, as an example, a public company must satisfy Companies House that at least £50,000 worth of shares have been issued and that each share has been paid up to at least a quarter of its face value. It will then receive an authorisation to commence business and to borrow.

A public company must have at least two directors and a suitably qualified secretary.

Private companies

There is no statutory minimum or maximum capital for a private company. It is now possible to set up a company with only one member and for that member to have only one share, but this is exceptional.

There must be at least two people involved in running a company. The company's articles may require that there are at least two directors, but if this is not the case and there is just one director, a separate person must be appointed as secretary.

COMPANY STRUCTURE & RESPONSIBILITIES

502.02 A COMPANY'S CONSTITUTION

Every company has a memorandum of association, which determines its name, where its registered office may be situated and what it may do (its objects).

The rules for the conduct of a company's internal affairs are contained in its articles of association.

Limited liability

A Company may have limited liability for its members. The effect of this is that, if the company is unable to pay its debts and is put into liquidation, the members will not be required to contribute more than they have actually paid or agreed to pay towards settling its debts.

502.03 DIRECTORS' POWERS AND RESPONSIBILITIES

A director is appointed to manage the affairs of a company in accordance with its articles of association and the law generally.

The directors are responsible for the management of the company. While their powers can be restricted by the company's articles they can in most cases do anything that the company can do. With these powers come responsibilities. Since the directors can act as and for the company, they must ensure that the company does everything that it is obliged to do by law and that the decisions they make are in the best interests of the company.

In this context, the interests of the company are those of the shareholders as a whole. These may be different from the interests of customers, employees, individual shareholders or the directors themselves.

Except where powers are delegated to a committee of directors or to a managing or executive director, the directors act collectively as a board. Individual directors do not have the authority to commit the company unless authorised by the board.

While decisions about the management of a company are a matter for the board as a whole, subject to the company's articles, the board may appoint one or more managing executives or directors with authority to commit the company without reference to the board.

Every company director has a personal responsibility to ensure that all statutory documents are delivered to the regulatory authorities when required. In particular:

- Accounts (usually only for limited companies)
- Annual returns
- Notice of change of directors or secretaries or in their particulars

It is often said that the Directors make the company policy and the Officers (employees) carry out the policy. As an example: The Board of Directors may lay out a certain company policy's; and, the President, Vice President or Managing Director will carry the responsibility of incorporating the companies policies.

502.04 ABOUT THE SECRETARY

Every company must have a secretary, who may or may not be a director. The secretary is appointed by the directors and is the company's chief administrative officer. As an officer of the company, the secretary shares responsibility for ensuring that all official documents are filed. This excludes only accounts, for which the directors are personally responsible for.

The company secretary of a private limited company needs no formal qualifications. However, a company secretary of a public limited company needs to meet certain qualifications. You are advised to check with either your accountant, your state regulatory bodies or such as Companies House.

The company secretary usually undertakes the following duties:

- Maintaining the statutory registers
- Ensuring that statutory forms are filed promptly
- Providing members and auditors with notice of meetings
- Sending the Registrar copies of resolutions and agreements
- Supplying a copy of the accounts to every member of the company, every debenture holder and every person who is entitled to receive notice of general meetings.
- Keeping, or arranging for the keeping, of minutes of directors' meetings and general meetings
- Ensuring that people entitled to do so, can inspect company records.
- Custody and use of the company seal.

502.05 WHAT IS A RESOLUTION?

A resolution is an agreement or decision on a matter taken by the directors or members (or class members) of a company. When a resolution is passed the company is bound by it. A proposed resolution is a motion. If the necessary majority is not attained than a proposed resolution fails.

What types of resolution are there?

There are eight types of resolution. These are as follows:

1. **Directors' Resolution**: Only used by directors at board meetings.

2. **Ordinary Resolution**: Used for all matters unless another type of resolution is required by the company's articles of association.

3. **Extraordinary Resolution**: Is required for certain matters, for example relating to winding up, or modifying class rights.

4. **Special Resolution**: Is passed at a general meeting of which not less than 21 days' notice specifying the intention to propose the resolution as a special resolution has been given.

5. **Elective Resolution**: the introduction of this new resolution is for five specific purposes, applicable to private companies only:

    - To amend the duration of the authority of directors to allot securities;

    - To dispense with the holding of annual general meetings;

    - To dispense with the laying of accounts and reports before the members in general meeting;

    - To allow the majority required to authorise short notice of a meeting and notice of a resolution to be reduced from 95% to a lower figure but not less than 90%

    - To dispense with the annual appointment of auditors.

6. **Written Resolution**: A private company may resolve by written resolution signed by all the members, or by resolution of any class of members, anything which may be passed by the company in general meeting (other than a resolution removing a director or auditor before the expiration of their term of office) without a meeting being held and without any previous notice being given. The resolution can only be passed by unanimous agreement of all the members entitled to attend and vote in person or by proxy at such a meeting.

7. **Class Resolution**: When a company proposes to pass a resolution which affects one class of share only, then it will usually be necessary to obtain the consent of the holders of the class of share, either in writing or by the passing of an extraordinary resolution at a separate class meeting.

8. **Shareholder Resolution**: This allows resolutions proposed by shareholders and which are intended to be moved at an annual general meeting; to be circulated at the expense of the requesting party (unless the company resolves otherwise) if either:

    - The shareholder(s) have 5% of the voting power of the company; or

    - The resolution is backed by 100 or more shareholders whose paid-up capital averages no less than £100 each.

SHARES AND SHAREHOLDERS

Selling shares in your company in one ay of raising long-term finance for your business. This is also known as equity finance. The advantage of equity finance is that you don't have to repay the finance or pay interest on it as you would with an overdraft or bank loan.

Shares represent ownership in a company. When an individual buys shares in a company, they become one of the owners of the business. This entitles them to a share of the distributed profits of the company, known as dividends.

502.06 WHAT ARE SHARES AND WHY ARE THEY ISSUED?

Shares represent ownership of a company. When an individual buys shares in your company they become one of the owners of the company. Shareholders choose who runs a company and are involved in making key decisions such as whether a business should be sold or not.

While shares are most obviously associated with the stock market, the majority of small businesses will not go anywhere near a stock market in their lifetime. Instead they are more likely to vie out shares in their company in return for a lump sum investment. This may either be from friends and family or, for businesses that are looking for high growth, through formal equity funding finance.

Formal equity finance is available through:

- Business angel investors
- Venture capital firms
- Stock markets

These investors are willing to put up capital for a share in a growth business. The advantage of raising money in this way is that you don't have to pay the money back or pay interest to the investors. Instead, shareholders are entitled to a share of the distributed profits of the company, known as dividends.

Selling shares in your company on a stock market can provide:

- New finance
- An exit for founding investors who want to realise their investment
- A mechanism for investors to trade shares
- A market valuation for the company
- An incentive for staff using shares or share options
- The business with an acquisition currency in the form of shares
- A way to raise your business' profile.

How are shares issued?

When you set up a company, you can decide on the level of share capital and the division of the share capital into fixed priced shares   Share's can be issued if it is a limited or unlimited company. In order to set this up, you need to draw up a document called the Memorandum of Association.

This sets out:

- The amount of share capital the company will have – i.e. the company's authorised capital
- The division of the share capital

The founders of the company subscribe (sign) the memorandum and state the number of shares they want. These are then issued upon incorporation. The money paid for the shares –which can be the nominal value or more –must be retained by the company.

You may choose to issue share to family in return for investment in your business. This may prove a better option than accepting the offer of a loan from them, as you are not obliged to make repayments to them. Formalising the agreement between family members is a good way of avoiding disputes that may arise in the future.

A company need not issue all its capital at once. Issued capital is the nominal – rather than actual – value of the part of the authorised share capital that has been issued to shareholders.

A company with an authorised capital of 1,000 shares at $1.00, which issues 500 share has an issued share capital of $500.

Public limited companies must have at least $50,000 of issued share capital – at least a quarter of this, plus any premium from selling the shares at a higher price, must be paid up before the company can start trading.

Any un-issued shares can be issued later by the directors, subject to the rules set out in the Articles of Association but typically through an ordinary resolution. The company sets the price of the shares.

- In **the United Kingdom** you need to register your company with Companies House. Companies House is the regulator and registry for limited companies. You must notify Companies House of any new shares issued.

Issuing shares to a new shareholder

A company can issue shares to a new shareholder by passing a directors resolution, and then completing and returning the required form (either to the State or in the UK to Companies House) within a month of the first allotment of new shares.

Changing the shares

A company can consolidate or subdivide shares if it is authorised to do so by the articles. Consolidation is when the shares are put together and then divided into shares of larger amount, e.g. 200 shares of $1.00 are consolidated to create 100 share of $2.00. Subdivision is when shares are divided into smaller amounts.

To consolidate or subdivide shares a company must pass an ordinary resolution to consolidate or subdivide shares, along with sending in the necessary completed forms either to the State or to Companies House (UK).

A useful website for UK Companies to order forms from Companies House:

http://www.companieshouse.gov.uk/forms/statFormsEW.shtml

502.07 TYPES OF SHARES

A company may have many different types of shares that come with different conditions and rights.

There are four main types of shares:

- **Ordinary shares** are standard shares with no special rights or restrictions. They have the potential to give the highest financial gains, but also have the highest risk. Ordinary shareholders are the last to be paid if the company is wound up.

- **Preference shares** typically carry a right that gives the holder preferential treatment when annual dividends are distributed to shareholders. Shares in this category have a fixed value, which means that a shareholder would not benefit from an increase in the business' profits. However, usually they have the rights to their dividend ahead of ordinary shareholders if the business is in trouble. Also, where a business is wound up, they are likely to be repaid the par value of shares ahead of ordinary shareholders.

- **Cumulative preference** shares give holders the right that, if a dividend cannot be paid one year, it will be carried forward to successive years. Dividends on cumulative preferred shares must be paid, despite the earning levels of the business.

- **Redeemable shares** come with an agreement that the company can buy them back at a future date – this can be at a fixed date or at the choice of the business. A company cannot issue only redeemable shares.

502.08 SALE AND TRANSFER OF SHARES

Share dealing is a complex area and specialist advice can be gained from solicitors, accountants and company law agencies.

Transfer and transmission of shares

Shares in a listed company are transferred through brokers using the Stock Exchange system.

Shares in a private or unlimited company are usually transferred by private agreement between the seller and buyer, subject to the company's own rules and approval of the directors.

- In the UK you need to pay Stamp Duty when you transfer shares.

Gains made on shares may be subject to Capital Gains Tax (CGT). In certain cases, shares are transmitted by law. This means that in the event that a shareholder dies or becomes bankrupt the shares and the rights associated with the shares are given to a personal representative or executor.

502.09 WHAT IS SHARE CAPITAL?

The share capital of a company is the fund which creditors of a company look to for security for payment of their debts.

What is authorised capital?

The "authorised" or "nominal" capital of a company, set by the company's first subscribers, is the amount in money up to which it may issue shares. The memorandum of the company must state how the share capital is divided into equal monetary units or groups of equal monetary units. The shares are then issued on the basis of these monetary units.

What is issued capital?

"Issued" capital is the nominal value of the company's shares (the value printed on the share certificate) actually issued to subscribers. The acquisition of issued capital makes a subscriber a member of the company. The amount of issued capital cannot exceed the amount of the authorised capital of a company.

What is allotted capital?

"Allotted" capital is a specific number of shares that subscribers to a company's memorandum agree to take on incorporation. The shares are deemed to be issued on incorporation and "allotted" to each member by due process of law.

Later, people wishing to become members of the company would be offered shares. The offer should specify the number and type of shares, the price to be paid, how it is to be paid and any conditions attached to the shares. If the offer is accepted the directors can then authorise the allotment so that the person responsible for maintaining the company's register of members can make the necessary entries and issue the share certificates.

What is paid-up, uncalled and reserve capital and share premium?

These terms are used to describe the make-up of a company's share capital:

- **"paid-up"** capital is the issued capital which has been fully or partly paid up by the shareholder;
- **"uncalled"** capital is that part of the issued capital on which the company has not requested payment;
- **"reserve"** capital is that part of the share capital that the company has decided will only be called up in the event of and for the purposes of the company being wound up;
- **"share premium"** is the excess paid above a share's nominal value. This excess must be recorded separately in the company books in a "share premium account".

Increase or decrease of authorised share capital

<u>A company can increase its authorised share capital by:</u>

- Passing an ordinary resolution – unless the Articles of Association require a special or extraordinary resolution
- Filing a copy of the resolution with State or in the UK Companies House

<u>A company can decrease its authorised share capital by:</u>

- Passing an ordinary resolution to cancel un-issued shares

502.10 DISCLOSURE REQUIREMENTS – THE ANNUAL RETURN

All company directors have a personal responsibility for making information about the capital structure, management and activities of their companies available both to the members of the company and to the State regulatory bodies.

The annual return gives details about the company's directors and secretary, registered office address, shareholders and share capital.

A Public Company – is literally 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 pubic companies are also monopolies.

OFFERING SHARES TO THE PUBLIC

502.11 INITIAL PUBLIC OFFERING

"IPO" an Initial Public Offering or referred to as a Flotation

The term "IPO" stands for an "Initial public offering" of securities. The term is usually used when a business has decided to "go public" to raise substantial amounts of capital by offering ownership interests in the company to the public at large.

A stock market flotation involves selling a percentage of your business in the form of shares on one of the stock markets. Floating your company can provide you with access to capital, an opportunity to cash in on your investment and a possible rise in your business' profile.

Many businesses don't have the solid profitability and growth potential required for a float and even those that do may not want to take on the costs, possible loss of management control and added regulatory burden that floating a company can bring.

See Suite 704 for considerably more detail.

Issuing a prospectus

If you want to list your company on the Stock Exchange or offer unlisted securities to the public, you need to publish a prospectus or listing particulars. Only a public limited company can do this.

The prospectus has three main functions:

- It sets out all the information that you must make public under the Listing Rules
- It acts as a marketing tool for shares in your company by describing the business and its prospects
- It sets out the price of your company's shares and how much capital you hope to raise

PAYING DIVIDENDS AND PAYING TAX

At the end of a year, a company's board decides whether the business has done well enough to pay shareholders a dividend. A dividend is a part of the company's profits that is given to shareholders. In large companies, it is common for an interim dividend to be paid at the half-year point. The dividend is calculated per share, so the more shares you own the more money you get.

Many company shares schemes allow employee shareholders to reinvest dividends in further shares called dividend shares. (In the UK) A maximum of £1,500 in dividends can be reinvested in this way each year. If an employee holds these shares for three years, they pay no income tax on them. If the shareholder does not keep the shares for three years, the dividend used to pay for the shares becomes taxable.

When paying dividends, the company must send a dividend voucher to the shareholder by post. This shows the amount of the dividend and the amount of tax credit. The tax credit shows the amount of tax paid by the company on the shareholder's behalf. Dividends are [paid after tax has been deducted. If you pay a higher rate of tax, you may be liable to pay additional tax on your dividend.

Statutory requirements and making changes

Directors of limited companies have certain obligations and regulations to meet. It is worthwhile consulting your accountants and lawyers about what these are.

502.12 DISCLAIMER AND GENERAL STATEMENT

The guidance notes above are sensible guidelines covering corporations in most of the below listed countries. However, it is wise to check with the official site of the country within which you wish to conduct business.

In order to check out the specific details contact the following sites for the respective countries.

Australia: http://www.business.gov.au

Canada / Ministry of Business / of selected Territory: http://www.canada.gc.ca

Ireland: http://www.basis.ie

New Zealand: http://www.govt.nz

South Africa: http://www.services.gov/za/service

United Kingdom: http://www.companieshouse.co.uk

United States of America: Since Corporate statutes vary from State to State: Please follow link within this site to: **Special Report** – The United State of America; Select "50 Sovereign States", then select State and Link to State Business Information.