



**A GUIDE TO ESTABLISHING A
BUSINESS IN THE UNITED KINGDOM**

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Ref: JSB/Gen/Guide to Establishing a Business in UK-D4

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**A GUIDE TO ESTABLISHING A BUSINESS
IN THE UNITED KINGDOM**

1. INTRODUCTION

1.1 General

This guide sets out some of the key issues which apply to the setting up of a UK business. We will be pleased to provide more specific advice on request.

1.2 United Kingdom

The UK has a common law legal system and so is to be contrasted with the civil systems which operate in Continental Europe. Legislation applies in addition to the common law.

The UK is divided into England and Wales (which constitutes a single jurisdiction) and the separate jurisdictions of Scotland and Northern Ireland. The laws of Scotland and Northern Ireland differ from those of England and Wales in a number of areas, such as land law.

The UK benefits from its position between the USA and the Far East in terms of time zones, from its sophisticated and mature markets, from London being a primary international financial centre, the language of English and long term stability. The absence of exchange control regulations and there being no limits on the repatriation of wealth from the UK are further attractive features.

1.3 United Kingdom within the EU

The UK is a member of the European Union, which presently has 27 member states. The European Union has steadily expanded since the original six member states (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) joined forces in 1951 to create a forerunner organisation. 12 of the member states (but not the UK) have a common currency, the euro.

Steps are being taken for the harmonisation of laws across the European Union in many areas, such as competition, consumer law and business law. However, the laws of each member state remain separate. The European Union includes the single European market, by which restrictions are disapplied to the free movement of goods, capital, services and people throughout the European Union.

1.4 **Guernsey, Jersey and the Isle of Man**

The Channel Islands are located in the English Channel. The largest islands are Guernsey and Jersey. They have separate legal systems from the UK, but their laws are closely modelled on UK laws. The Isle of Man, which is located in the Irish Sea, has its own system. All three off-shore jurisdictions can be attractive in regulatory and fiscal terms. We have close links with a number of firms in these off-shore jurisdictions and work with them regularly in structuring and implementing transactions.

1.5 **Alternative ways of establishing a UK business**

There are three routes to establishing a corporate presence in the UK:

- establishing a new UK incorporated company (as discussed in section 2 of this guide);
- acquiring a UK incorporated company which is already trading (as discussed in section 2.12 of this guide); and
- registering a branch or place of business (as discussed in section 3).

There are further alternative routes to establishing a business presence in the UK:

- establishing, or acquiring an interest in, a vehicle which is not a company, such as a limited liability partnership. Limited liability partnerships may be worth considering for example where a fiscally transparent vehicle is required (though limited liability partnerships are not transparent for the purposes of the UK sales tax, VAT). Limited liability partnerships are considered further in section 4 of this guide; and
- entering into a partnership, joint venture or other contractual arrangement with a UK business. We are able to advise on such arrangements (some aspects of which are described in section 2.13 of this guide).

2. **UK INCORPORATED COMPANIES**

2.1 **Introduction**

The standard vehicle for carrying on business in the UK is the limited company, as incorporated under the Companies Act 1985 (the "**Act**"). A UK company is a separate legal entity. It can be unlimited, limited by guarantee or, much more commonly, limited by shares. The Act is gradually being replaced by the Companies Act 2006 over the course of 2007 and 2008, although the substantive changes in UK corporate law are quite few.

In the UK there are advantages and disadvantages of conducting a business using a company which is limited by shares. The main advantage is the protection of limited liability for the owner investors (the shareholders) and the managers (broadly, the directors). The shareholders are protected because, should the limited company become unable to pay its debts in full, the creditors will have no claim against the shareholders in excess of the amounts that have been specified in advance as due payment for their shares. The liability of the shareholders on a winding-up is in general limited to any amount unpaid on the shares they hold. Provided the shareholders have not entered into any collateral arrangement, such as a personal guarantee, and the shareholders have not conducted themselves in so unacceptable a manner that justifies ignoring the limited nature of the vehicle (which is called "piercing the corporate veil"), they are protected. The directors are also protected from creditors in that provided they have fulfilled their common law and statutory duties (and again there are no collateral arrangements etc), they are not answerable for the debts of the company. The reference to the company being "limited" is to the limitation of the liability of the shareholders (and not the directors), but more broadly speaking it is the case that UK limited companies are vehicles by which business activities can be conducted with only restricted or "limited" recourse to both the owner investors and managers.

In return for the advantage of limited liability, there are a number of controls. UK limited companies are required to prepare annual accounts and have them audited and registered with the Registrar of Companies (sometimes called "Companies House"). The process of registration is very simple and inexpensive as it involves only the delivery of the accounts: there is no process of approval or checking by the Registrar. However, it does mean that the accounts are public documents: any person can inspect the accounts. In addition, UK companies are required to keep the Registrar of Companies informed about changes at the company as to the directors, shareholders and other matters. Furthermore, certain records need to be kept by the company itself.

As well as these requirements, UK companies need to abide by UK company laws. These include laws on maintenance of capital, by which UK companies are restricted in their ability to repay to their shareholders the amounts which the shareholders have

advanced, or agreed to advance, as shareholder capital. The share capital is the risk capital of the shareholders and potential creditors can legitimately expect, in deciding whether to lend amounts to the company, and how much to lend, that the amounts advanced by shareholders will not just be returned to them. In short, the share capital is the "buffer fund" which is generally expected to remain in place as far as possible. There are, of course, various other laws including as to the proper conduct of the directors, requirements as to the issue of new shares and controls which apply if a company faces serious financial difficulties.

In choosing between operating in the UK as a subsidiary or as a branch, one key consideration is that a UK subsidiary generally has the benefit of limited liability, whereas an overseas company is responsible for the obligations of its branches.

2.2 Private limited companies and public limited companies

UK companies limited by shares can be either private or public limited companies. Most companies which are incorporated in the UK are private limited companies.

All UK companies, including private limited companies, have a constitution which is divided into two documents, being the memorandum of association and the articles of association. The memorandum of association of a company sets out the objects for which the company is incorporated and the activities which it is empowered to carry on. Where the memorandum states that the object of the company is to carry on business as "a general commercial company", it may carry on any form of legal trade or business and it is deemed to have all the powers which are incidental or conducive to that.

The articles of association contain the regulations governing the company's internal management. For a wholly-owned subsidiary, these are typically in a relatively standard form. One standard form of articles which is often used is call the "Table A" form of articles. Special provisions may be desirable where the parent company is a foreign corporation and/or directors reside overseas.

A private limited company need have only one shareholder. Wholly-owned subsidiaries are generally formed with their parent company as the sole shareholder.

Larger UK limited companies may be public limited companies. Public limited companies (the names of which end with the words "public limited company" or "plc") are subject to a number of requirements which are in addition to those applying to private limited companies. For example, the issued share capital of a public limited company must be at least £50,000 of which at least 25% (and any premium) must be paid up.

A private company limited by shares (the name of which will end with the word "Limited" or "Ltd") may not usually offer its securities to the public in the UK. This explains why it may be appropriate to be a public limited company: although there are additional legal requirements for public limited companies, they have the advantage over private limited companies that they can offer their shares and other securities to the public in the UK. It follows from this that many of the largest and most successful UK companies, which are listed on the London Stock Exchange or on AIM, are public limited companies. Being a plc carries some prestige with it as a result. On the other hand, there are of course many highly successful private limited companies which have decided not to go public and list.

The Registrar of Companies maintains an index of names of all the companies in the UK. It is not possible for a new company to use the same name as an existing company. The use of certain words such as "UK" and "International" requires the consent of the Registrar of Companies. Care must also be taken not to infringe any subsisting trade mark or other intellectual property rights or to damage a third party's goodwill.

2.3 **Management**

The management of the business of a UK company is conducted by its board of directors, although they may delegate some or all of their powers to a managing director. Many companies have a combination of executive directors, who are involved in the day to day management of the company, and non-executive directors, whose role is to support the executive directors in their conduct of the business and to monitor and supervise their conduct.

All directors, both executive and non-executive, are subject to common law duties (including the duty to exercise reasonable skill and care in the conduct of their duties) which are owed to the company as a whole and not to individual shareholders, although in certain circumstances shareholders may take action against the directors where their interests have been unfairly prejudiced. There may also be circumstances where directors assume a duty of care to other parties, for example, to the creditors of the company where the company is approaching insolvency or to a third party where there has been a personal assumption of responsibility.

In recognition of these potential liabilities, many companies agree to indemnify their directors in respect of such liabilities although the Act does impose restrictions on the extent to which indemnification can be provided. Many companies also take out Directors and Officers' liability insurance to cover the personal liabilities of the directors (and other officers/senior managers) in relation to both claims and regulatory investigations and the liabilities of the company in so far as the company has agreed to indemnify its directors. The terms of any D&O policy vary enormously and great care

needs to be taken to ensure that the interests of the individual director, and of the company, are properly protected.

A company formed in the UK must have at least one director and a company secretary (who carries out the formal administrative functions of the company). Where there is a sole director, that person cannot also be the company secretary. There is no requirement that the directors or the secretary should be citizens of, or resident in, any part of the UK or the EU, but in practice it may be convenient to have a local director.

2.4 Accounts and auditors

Under the Act, the accounts of all UK companies must give a "true and fair view" of the state of the company's affairs as at the end of its financial year and of its profit or loss for the financial year then ended. Annual accounts must be prepared and reported on by the auditors. (Small companies which satisfy specified conditions are exempted from the requirement to have their annual accounts audited and dormant companies are also exempted.)

The first financial period must not be shorter than six months, but may be as long as 18 months from the date of incorporation. Otherwise, the financial period is usually 12 months.

2.5 Annual Return

Every UK company must file an "Annual Return" (Form 363) with the Registrar of Companies stating its current registered office address, up to date details of all directors and the company secretary, and changes to the issued share capital and shareholders. The information is then publicly available.

2.6 Companies House - filings and changes

Notification to the Registrar of Companies is required of certain matters including:

- any change in the directors and company secretary of the company or of their particulars;
- any change in the registered office of the company;
- any changes to the memorandum or articles of association or the share capital of the company; and
- mortgages over company property.

2.7 **Company records**

UK companies are under a duty to maintain company records detailing (among other things) the shareholders, directors and company secretary and mortgages over assets. In addition, the company records need to be kept up to date in respect of certain matters including:

- any change in the directors and the company secretary of the company or of their particulars; and
- any changes to the memorandum or articles of association or the share capital of the company.

2.8 **Registered office**

All UK companies need to have a registered office. This is the location where legal proceedings may be served on the company and where certain registers and company documents must usually be kept. Kirkpatrick & Lockhart Preston Gates Ellis LLP provides registered office facilities to clients needing them.

2.9 **Annual general meeting**

UK companies need to hold an annual general meeting of their shareholders in each calendar year. At the annual general meeting, the annual report and accounts are received, any dividend is declared, and directors and auditors are appointed or reappointed. The first annual general meeting must be held within 18 months of incorporation, and not more than 15 months must elapse between subsequent annual general meetings. (A private company may elect, by means of an "elective resolution" complying with certain statutory formalities, to dispense with the holding of annual general meetings.)

2.10 **Establishing a UK company**

The documents required to establish a new company are:

- the memorandum of association;
- the articles of association;
- a short form setting out the names of the directors and company secretary and the situation of the registered office (Form 10);
- a statutory declaration applying for registration (Form 12); and

- a registration fee.

2.11 **Buying a shelf company**

Alternatively, it is possible to purchase a private limited company "off the shelf". These are "nearly new" companies which have never traded but which have been incorporated and so already exist. Specialist firms, called incorporation agents, are in the business of incorporating shelf companies so that they can be taken over and used by the new owners to conduct business.

If a shelf company is being purchased, then the initial filing requirements will be the resignation of the existing directors and company secretary (usually being individuals who work at the incorporation agent) and the appointment of new directors and company secretary. It will also be necessary to change the location of the registered office and, if desired, the company's name. We have links with incorporation agents and often manage this process for our clients.

Whether a brand new company is incorporated or a shelf company is used, the next step will be to hold a board meeting to get the business going in the name of the company. The directors will appoint auditors and initiate arrangements for banking. The company secretary will be instructed to file any forms with the Registrar of Companies and to get the company records prepared. The company may need some help with the board agenda and minutes and often we prepare them to start matters off. The company can then get on with its business.

2.12 **Acquisition of a UK incorporated company which is already trading**

Another option is the acquisition of an existing trading company, operating in the same market as the one the overseas company is intending to enter. This will incur a greater initial expenditure than setting up a new company but the overseas company may gain immediate local presence and expertise from the target of the acquisition.

Specific advice should always be taken on planning and executing an acquisition and we are able to advise on such matters. Mergers and acquisitions are one of our core activities. In particular, matters which arise on the purchase of a company are:

- entering into heads of terms (or a memorandum of understanding), including terms as to confidentiality and exclusivity;
- valuation, agreeing the price and structuring the consideration (for example, as to cash, shares and other securities, whether the consideration will be deferred in whole or part and whether there will be an earn-out);

- legal and financial due diligence by which the company being acquired is appraised; and
- the preparation of contractual documentation (which the buyer's lawyers usually draft), including the purchase agreement, tax indemnity and related agreements and its negotiation and implementation.

2.13 Partnerships, joint ventures and other contractual arrangements

As an alternative to establishing a subsidiary or a branch in the UK, it may be appropriate to enter into a contractual arrangement with an existing UK business. Such an arrangement may have the advantage of not having the costs of setting up a standalone business, and may be sufficient when the activity that will be conducted in the UK is limited. Where there is no permanent establishment in the UK there will not usually be UK corporation tax to pay.

One form of contractual arrangement would be an investment by the overseas company in a joint venture, which often will be a limited liability company. The shareholders' agreement will typically regulate matters such as:

- the terms of the initial investment, including as to equity and loan capital;
- corporate governance issues, so that it is agreed how decisions will be made, and by which parties, at board and shareholder levels;
- the process by which business plans are developed and implemented and by which financial and other information is prepared and circulated;
- distributions; and
- exit terms, such as pre-emption rights, drag-along and tag-along rights, and rights on an IPO.

A lower cost means of entering the European market, and one which is very common, is to appoint a distributor or agent to promote the supplier's products or services. In making such an appointment there are certain key issues to consider:

- The advantages and disadvantages of an agency relationship vis-à-vis a distribution arrangement. The key advantage of agency is that it allows the supplier to maintain greater control over the marketing of its products, by, for example, specifying the price at which the agent is to sell its goods. Disadvantages are that EU law on agency requires, in certain circumstances, for as much as two years' worth of commissions to be paid to the agent on

termination of the relationship. Furthermore, an agency relationship implies by its nature that the financial risk remains with the supplier (e.g. for non-payment by customers or for unsold stock). Appointing a distributor passes much of the financial risk away from the supplier, but also control as to pricing and the customers to whom the goods or services may be sold.

- Consider whether an exclusive appointment is appropriate or desirable (see also competition law discussed separately below). Note that absolute territorial protection is unlawful under EU law - exclusive distributors must remain free to respond to passive orders made by customers in Member States outside the exclusive territory.
- Decide on the relevant territory - in many cases separate agents/distributors for each European country will need to be appointed since only they will have the relevant local knowledge.
- Decide whether to permit the appointment of sub-agents and/or sub-distributors. How tightly does the supplier wish to control the supply chain ?
- Anyone selling goods or services into the European market needs to take advice on the potential liabilities arising from selling faulty or dangerous goods. Exclusion of liability clauses are common but must be carefully drafted as there are limits under EU and national laws as to the extent to which liability can be excluded.
- How will the intellectual property rights of the supplier be protected. In some cases separate licences of relevant IP are drafted in favour of the agent or distributor; in most cases provisions are included in the main agency or distribution agreement. The supplier will want to set out carefully which rights the agent/distributor is permitted to use and will also wish to ensure that the agent/distributor acts as its eyes and ears in the relevant market to identify any infringements of IP rights by third parties.
- Consider whether the appointment of an agent will have any tax implications for the supplier, for example if the agent is able to sign contracts on behalf of the supplier, that may create a permanent establishment of the supplier.

As well as agency and distribution arrangements, a business may wish to enter a new European market using a franchise model, whereby the franchisee is given detailed instructions on all matters pertaining to the operation of the business. The franchising model is common in the food and retailing sectors. Such arrangements normally require significant investment by the franchisee but are becoming increasingly common in the UK and Europe generally.

Finally, will "distance sales" be made (directly or indirectly), i.e. those by internet, post or telephone? If so, consideration must be given to the EU Distance Selling Regulations which require inter alia that specific information be given to consumers and that consumers have a cooling off period during which they may cancel the contract for a specific period after the sale has been made. Separate regulations apply to financial products and services.

For advice or further information about any aspect of UK corporate law please contact one of the corporate partners in the London office. Their names and contact details are available on the K&L Gates website.

3. **ESTABLISHING A BRANCH OR PLACE OF BUSINESS**

3.1 **Introduction**

An alternative to setting up a new UK subsidiary is to establish a "branch" or a "place of business". Branches and places of business are not separate legal entities. This section of the guide sets out the main legal issues concerning the establishment of a branch or of a place of business.

There are essentially two key issues. Firstly, whether the UK activity is significant enough to mean that registration of a branch is required. It may be that the UK activity does not require branch registration but does require registration as a place of business, though in practice registration of a branch is more likely. Secondly, there are the separate regimes for branches and places of business in terms of registration and other compliance requirements.

3.2 **Registering a branch or a place of business**

The fact that a foreign company is carrying on business with another party which is based in the UK does not automatically mean that it must register with the Registrar of Companies. The holding of an investment, including investment property, in the UK, may not in all circumstances necessitate registration. However, the Act requires every foreign company which establishes certain operations in the UK to deliver certain documents to the Registrar of Companies.

This guide only deals with England and Wales and, to establish a business in Scotland or Northern Ireland, separate registration will be required.

A limited company will be deemed to have established a branch in the UK if its operations in the UK have the following features:

- the appearance of permanency;
- the presence of managers on the premises; and
- the ostensible authority of branch personnel to conduct business with third parties on behalf of the company.

A branch will be deemed to exist generally when part of the company is organised in the UK to conduct business through local representatives rather than referring it abroad. A branch is a legally dependent part of the company which conducts, directly or indirectly, all or some part of the operations inherent in the business. Generally, any establishment in the UK which goes beyond that of (for example) administration or

warehousing facilities which are merely incidental and ancillary to the business as a whole will require registration as a branch. If the presence in the UK is less than that of a branch the presence will be required to comply with the place of business regime. There will be a place of business where there are activities which have some degree of permanence, recognisability and regularity from a UK location. However, if the company establishing the presence in the UK is not a limited company the option of branch registration is not open to it, even if the operations in the UK have the characteristics of a branch.

3.3 **Registration of a branch**

Within one month after establishing a branch in Great Britain, pursuant to section 690A and Schedule 21A of the Act, the following must be delivered to the Registrar of Companies:

- Form BR1, detailing (among other things) name, trading name (if different), directors, secretaries, constitutional details (if not covered below), nominated person or persons to receive service of legal documents and the accounting reference date. (The accounting reference date of a company is the date in each year to which the accounts are to be made up. For a new registration of a place of business/branch the date will be set by reference to the date of establishment in the UK. Accounting reference dates can be changed subject to certain rules.);
- a certified copy of the company's constitutional documents, with, if necessary, a certified English translation;
- a copy of the latest set of audited accounts required to be published by the law of the "parent" state; and
- a registration fee.

Any changes to the matters disclosed must be notified.

3.4 **Registration of a place of business**

The registration and compliance regime for places of business is separate and different from the regime for branches. Within one month after establishing a place of business in Great Britain, pursuant to sections 691 and 692 of the Act, the following must be delivered to the Registrar of Companies:

- Form 691, detailing (among other things) the directors, secretaries and accounting reference date of the overseas company and nominating a person or

persons authorised to accept service of legal documents in the UK;

- a certified copy of the company's constitutional documents (for example, certificate of incorporation and by-laws), with, if necessary, a certified English translation; and
- a registration fee.

Any changes to the matters disclosed must be notified. These requirements are less extensive than the equivalent requirements for a branch (as summarised in para 3.3 above).

3.5 **Business names**

The Registrar of Companies maintains an index of names used by all companies in the UK. Companies may not use a name already appearing on the index. Pursuant to section 694 of the Act, the name of a foreign company being registered as a branch or place of business is subject to the same restrictions.

3.6 **Ongoing requirements and disclosures**

All branches in the UK of foreign companies must file audited accounts. Where the company is obliged under the law under which it is incorporated to prepare, have audited and disclose accounts, section 699AA and Part I of Schedule 21D of the Act require the filing of those accounts with the Registrar of Companies (with a translation if the accounts are not in English).

Where the foreign company with a UK branch is not obliged under the law under which it is incorporated to prepare, have audited and publicly disclose accounts, the company must, usually within 13 months of the company's accounting date, deliver accounts to the Registrar of Companies. Pursuant to Part II of Schedule 21D and section 700 of the Act, the company needs to prepare the accounts and a directors' report, and cause an auditors' report to be prepared as would be required had the company been a UK company. Some modifications may be made to this, but the general position is therefore that the use of a branch will involve the public disclosure of the company's accounts (and not just accounts for the branch operations).

Where a place of business has been established, pursuant to section 700 of the Act a directors' report and audited accounts must also be filed as if the company were incorporated in the UK (however there are some matters which may be omitted). The material must usually be delivered within 13 months of the end of the relevant financial period.

A special regime applies to credit and financial institutions (pursuant to section 699A and Schedule 21C to the Act).

A charge over the assets of a foreign company which has an established place of business in the UK must be registered if the charge is over property in the UK. The obligation to register the charge arises at the time of creation of the charge or at the time that the property over which the charge is created is acquired by the company. The obligation to register the charge will arise even if the company has not registered a branch or place of business in the UK when obliged to do so.

For advice or further information about any aspect of setting up a branch or a place of business in the UK please contact Stuart Borrie, partner in the London office on +44 (0) 207 360 8155 or by email on stuart.borrie@klgates.com.

4. **LIMITED LIABILITY PARTNERSHIPS**

4.1 **Introduction**

In addition to considering whether to establish the business in the UK as a new subsidiary or as a branch (or place of business) of an existing overseas company, it is worth considering alternative vehicles. One of the main alternative vehicles in the UK is the limited liability partnership. It has been possible to incorporate LLPs in the UK since April 2001.

Limited liability partnerships need to be seen in the context of older types of legal structure:

- the limited company (as discussed in section 2 of this guide);
- the general partnership, as constituted by a partnership agreement and subject to the Partnership Act 1890; and
- the limited partnership, as constituted by a partnership agreement and subject to the Limited Partnership Act 1907.

Companies incorporated under the Companies Act 1985 are the standard vehicle used for commercial activities in the UK. As discussed in section 2, they have some attractive features. However, companies may not always be the most appropriate vehicle because profits are taxed both at the corporate level and then again at the investor level when profits are distributed.

In relation to general partnerships all partners are jointly liable for all the debts and obligations of the partners and are jointly and severally liable for any loss and damage arising from any wrongful acts or omissions of their fellow partners. The potential liability of a partner to third parties is unlimited.

Another alternative existing structure is the limited partnership. The limited partnership structure may not be suitable for many business enterprises because the limited partners may not take part in day to day management. In addition there is a requirement for there to be a general partner which has unlimited liability to third parties.

4.2 **LLPs**

LLPs are bodies corporate with separate legal personality from their members but they can still be managed like partnerships. There is no board of directors but there are members who have characteristics of both directors and shareholders. There is no

prescribed means by which a limited liability partnership must be managed. Accordingly, the members can agree amongst themselves as to how the LLP shall be managed and controlled. The members have complete flexibility in this in the same way as partners in a partnership.

Limited liability partnerships are legal entities in their own right and accordingly liabilities to third parties can be ring-fenced within the limited liability partnership thereby limiting the liability of members. The limit is to the amounts that the members have contributed to the vehicle by way of capital together with amounts that may be owed to them by the vehicle.

It is however possible for the corporate veil to be pierced and for members to have direct liability to third parties if, for example, they were to agree to guarantee to a third party performance by the LLP of its obligations. This might for example happen in relation to the LLP's banking facilities or its holding of leasehold property.

4.3 **Agency**

An important feature of a general partnership is that the partners are agents for each other and bind each other. By contrast the members of a limited liability partnership are, when they agree that the LLP is to enter into a contract, acting as agents of the LLP and not of each other. There is, by contrast with a general partnership, no joint and several liability between the members of an LLP. Notwithstanding the limited liability of members, members may in certain cases be liable in negligence if they have assumed a personal duty of care.

4.4 **Body corporate**

LLPs are legally closer to companies than to partnerships. Pursuant to the Limited Liabilities Partnerships Regulations 2001, many provisions of the Companies Act 1985 are applied to limited liability partnerships (with minor consequential amendments to ensure that the sense of the provisions is retained). For example, the Companies Act provisions relating to fraudulent trading and wrongful trading apply to LLPs. In addition a limited liability partnership can have shadow members just as a company can have shadow directors. Other statutes are modified insofar as they relate to limited liability partnerships - for example the Insolvency Act 1986 and the Company Directors Disqualification Act 1986. Provisions relating to the disqualification of directors are applied to the disqualification of members. The insolvency and winding-up rules which apply to companies apply with very few amendments to limited liability partnerships.

4.5 **True and fair accounts**

One of the key perceived advantages of a general partnership is that it is private - the accounts do not need to be filed with the Registrar of Companies and the partnership agreement is a private document. In relation to LLPs the situation is different in that there is greater public disclosure. In particular, an LLP must file "true and fair view" accounts. These differ from the accounts that a general partnership is required to keep and in some respects need to be more detailed. In addition, competitors may have greater access to information as to how a business organised as an LLP (as opposed to a general partnership) conducts its business - for example as to the margins that it operates and its control of its costs base.

4.6 **Maintenance of capital**

There are no maintenance of capital provisions for LLPs.

4.7 **Clawback**

There is a rule specific to limited liability partnerships, which is sometimes known as the "clawback rule". It has the effect that a member in a limited liability partnership may be more exposed to liability than a director or a shareholder of a company.

The clawback rule is derived from company law - i.e. wrongful trading and fraudulent trading rules. The clawback rule affects amounts withdrawn by members in the two years before commencement of winding-up. A liquidator of the limited liability partnership may be able to clawback from members amounts withdrawn in that period by members for the benefit of creditors if the person making the withdrawal knew or ought to have concluded that after the withdrawal and any withdrawals in contemplation at the time, there would be no reasonable prospect that the LLP would avoid an insolvent liquidation.

4.8 **Formation of LLPs**

An LLP can be incorporated where two or more persons associated with carrying on a lawful business with a view to profit have subscribed their names to an incorporation document. There is no limit on the number of members in a limited liability partnership.

There is no restriction on the type of business that an LLP may carry on.

The incorporation document is the short form that is sent to Companies House (Form LLP2). One of the matters that needs to be concluded before Form LLP2 is sent to Companies House is the decision as to which of the members of the LLP will be

designated members. The designated members have the same rights as other members but have additional statutory responsibilities in relation to matters such as the filing of the LLP's accounts and annual return and the appointment of an auditor.

Notifications of changes in designated members and the LLP's registered office need to be made to the Registrar of Companies.

4.9 **Constitution**

There is no equivalent of Table A for LLPs and no set way in which a limited liability partnership can or should be managed. LLPs have no memorandum and articles of association. All the matters which would otherwise be dealt with in the memorandum and articles of association should normally be covered in the members' agreement.

4.10 **Members' Agreement**

The members' agreement is a private document and does not need to be filed with the Registrar of Companies.

In the event that there is no members' agreement, there are some statutory default provisions but these are only in outline form. In summary, they include equal profit and loss sharing between members, equal sharing of capital, equal rights to manage between members, unanimous approval between members for any additional new member, no right to remuneration and no right to expel a member. These rights and obligations are unlikely to be suitable so a members' agreement is likely to be needed.

4.11 **Taxation**

An LLP is treated in the UK as being tax transparent (unless it is in dissolution). The effect of this is the same as for a general partnership in that partners are taxed separately on their appropriate proportion of the profits of the partnership business and also are entitled to an appropriate share of losses and capital allowances.

Limited liability partnerships are analogous to partnerships in relation to income tax treatment and corporation tax treatment. An advantage of the partnership structure is that partners do not have to account for employer's National Insurance contributions in relation to partners' profit shares and this advantage is also carried over into limited liability partnerships.

However, an LLP is treated like a company for VAT purposes and can be registered for VAT in the ordinary way just like a company.

4.12 Uses

As well as being a vehicle for professional partnerships, LLPs can be used by many types of business such as joint ventures, entrepreneurial businesses and investment structures. Entrepreneurs often use a general partnership structure and it may be possible for them to generate the same kind of culture within a limited liability partnership. The LLP may be perceived as a popular vehicle for businesses where they wish to motivate key staff by making them members but where limited liability is thought to be important and the public disclosure requirements are accepted.

Joint ventures can of course take the form of virtually every available legal structure depending on the aims and objectives of the parties and the LLP structure can be used. The LLP structure is flexible and it is possible to structure management and profit and loss sharing in way that suits the parties. The members' agreement, as noted above, is private and there are no restrictions on the withdrawal of capital. Accordingly, there is no need for complex subordinated debt structures to allow withdrawals by investors without an authorised reduction of capital.

4.13 Brief Summary of the similarities and differences between Limited Companies and LLPs

	Companies	LLPs
Legal Status	A limited company is a separate legal entity capable of entering into contracts and owning property.	An LLP is also a separate legal entity capable of entering into contracts and owning property.
Liability	Liability of shareholders of a limited company is limited and they will not, generally, be liable beyond such limit for the company's debts or liabilities. Directors acting with authority and in accordance with statutory requirements and directors duties will not be liable.	Liability of Members is limited and they will not, generally, be liable for the LLP's debts or liabilities.
Dealings with third parties	Only directors of a company have capacity to deal with third parties and act as the agents of the company. Generally, shareholders have no such authority.	Generally, every Member of an LLP is an agent of the LLP with power to bind it (although a Members Agreement may provide that a Member has no actual authority in this respect).

	Companies	LLPs
Relationship between shareholders / members	Shareholders of a company are bound to act in accordance with the company's Articles of Association which forms a contract between the shareholders. A Shareholders Agreement may also be adopted which will bind the parties to it. Unlike the Articles, it will be a private document.	There is no obligation on the Members to act in accordance with a formal agreement. However, it is advisable that the Members do enter into a formal agreement or the default provisions set out in the LLP legislation will apply (these provide for equal share of profits amongst other things).
Filing requirements	Limited companies must file certain registers and records at Companies House. Annual Accounts need to be filed.	LLPs must file financial and membership details with Companies House. Annual Accounts need to be filed.
Taxation	Corporations are "opaque" for tax purposes (i.e. they are taxed separately from their shareholders). Companies pay corporation tax at rates of up to 30%. (Any money transferred to shareholders by way of dividend will attract a further charge to tax for the recipient. A higher-rate taxpayer will pay an effective rate of 25% tax on dividends received.)	LLPs are tax transparent (except in respect of VAT) and their members are assessed to tax on their share of the profits. LLPs may offer National Insurance Contributions advantages.
Management structure	Directors operate the company on a day to day basis with shareholders having the ultimate control on matters such as removal of directors and the passing of significant resolutions.	<ul style="list-style-type: none"> ● LLP must have at least two "designated" Members to comply with the legislation and to ensure appropriate administration ● If no members separately named as "designated" Members, all Members will be construed as such ● Agreement may be put in place to define roles further
Appointments	Directors are appointed by directors, subject to approval by the shareholders	<ul style="list-style-type: none"> ● Consent of all Members must be obtained to appoint a new Member ● This is a default provision and may be amended by an express agreement.

	Companies	LLPs
Cessation	Directors may be removed by rotation, they may resign or they may be removed by an ordinary resolution of the company in general meeting.	<ul style="list-style-type: none"> ● Member may cease to be a member on death, agreement or on notice ● A member cannot be removed without his agreement unless such action is provided for the LLP agreement.
Transfer	<ul style="list-style-type: none"> ● Shareholders, subject to the Articles, may generally transfer shares ● Transferees of shares, including by transmission on bankruptcy or death, generally have the same rights and liabilities as shareholders as transferor 	Subject to the terms of the LLP agreement, membership may be assigned or transferred

For advice and further information about LLPs please contact please contact Stuart Borrie, partner in the London office on +44 (0) 207 360 8155 or by email on stuart.borrie@klgates.com.

5. **FINANCING THE BUSINESS**

5.1 **Internal financing**

The form of financing of a UK business will depend to a large extent on the legal structure chosen by the overseas company to carry out business in the UK.

Depending on the circumstances, a parent can provide finance to its subsidiary in one or more of the following principal forms:

- share capital;
- loans (short, medium or long term and with or without interest);
- extended trade credit (interest bearing or non interest bearing); and
- guarantees of local borrowings.

Obviously a branch or place of business is not a separate corporate vehicle and any financing requirement is generally arranged by the overseas company itself.

The tax implications of the capital structure and sources of finance can be complex and tax advice should always be obtained.

5.2 **External financing**

In principle, finance can be raised in sterling or other currencies from banks and financial institutions both by UK subsidiaries of overseas companies and branches/places of business. Mortgages and charges over property given by companies and by branches and places of business of overseas companies need to be registered with the Registrar of Companies.

5.3 **Financing issues**

Key issues in respect of financing include:

- the rate of return on the funding, whether it is legally characterised as interest or dividends;
- the tax treatment of the return;
- the priority/ranking of the return and the capital amount;

- the risks associated with the financing and the security for the financing. Any security may need to be registered;
- what rights and protections arise in respect of the financing eg voting rights in respect of equity share capital, and covenants in respect of debt financing; and
- the period of the financing and the process by which the investor can exit.

For advice or further information about financing please contact one of the corporate partners in the London office. Their names and contact details are available on the K&L Gates website.

6. FINANCIAL SERVICES

6.1 Introduction

Businesses carrying on financial services in the UK are subject to additional requirements over and above those set out in the Companies Act 1985. Those additional requirements are set out in the Financial Services and Markets Act 2000 ("**FSMA**"), related regulations and other financial legislation. The main provisions of the FSMA relating to the regulation of financial services in the UK came into force on 1 December 2001. The FSMA itself provides a framework for the regulation of financial services with the detail being contained in secondary legislation, such as the FSMA 2000 (Regulated Activities) Order 2001 ("**RAO**") which details the activities for which FSA authorisation is required.

The Financial Services Authority ("**FSA**") is the UK's financial services regulator as well as being the UK's 'competent authority' under European single market directives for banking, insurance, investment, securities listing, and other financial services matters. It derives its power and authority from FSMA. The FSA regulates investment business, deposit-taking institutions, mortgages (any other lending secured against residential property), insurance and investment markets. The FSA also enforces the regulations and provides services to consumers, industry and other regulators. It is financed by levies on the industry and has extensive powers, including powers to investigate and gather information, apply to the court for injunctions or restitution orders, make a restitution order itself, prosecute, impose civil fines and censure a person publicly.

All the FSA's activities revolve around ensuring that it achieves four principal statutory objectives set out in FSMA:

- maintaining market confidence in the financial system;
- promoting public understanding of the UK financial system;
- protecting consumers; and
- reducing financial crime (including activities such as money laundering, financial fraud and dishonesty, and market abuse and market misconduct).

6.2 Requirement for authorisation

Under section 19 of the FSMA no person may carry on a regulated activity in the UK (or purport to do so) unless they have been authorised by the FSA or they are exempt. Breach of this 'general prohibition' is a criminal offence and any agreement reached by

an unauthorised (and not exempt) person in the course of carrying on regulated activities is unenforceable. The key criminal offences are:

- carrying out a regulated activity without authorisation;
- falsely claiming to be authorised or exempt; and
- unauthorised financial promotion.

There are certain exemptions that may sometimes apply to an overseas (i.e. non-UK) person carrying out a regulated activity within the UK. However, an overseas person which intends to carry on regulated activities from a permanent place of business in the UK will generally need to become FSA authorised before it can do this.

6.3 **Regulated activities**

Under section 22 of the FSMA an activity is a regulated activity if it is:

- "an activity of a specified kind";
- "carried on by way of business"; and
- "relates to an investment of a specified kind".

The RAO specifies certain activities and certain investments and also provides for exclusions to certain activities in particular circumstances.

6.4 **Regulated investments**

The main types of regulated investments are:

- shares (of any type in any type of company);
- loans (such as bonds, debentures and government gilts);
- collective investments (such as unit trusts, OEICs and stakeholder pensions);
- insurance (such as endowments, whole life insurance, personal pensions, annuities and insurance bonds);
- mortgages (and other loans secured against residential property); and
- deposits.

6.5 **Examples of regulated activities**

Some of the principal regulated activities are:

- accepting deposits;
- effecting a transaction by dealing (this involves buying, selling, subscribing for or underwriting securities or contractually based investments as agent or principal);
- making arrangements for another person to effect transactions in securities or contractually-based investments;
- custodial services (such as managing or safeguarding investments);
- advising on specific investments (this covers both specific positive and negative advice to a person or agent in his capacity as investor/potential investor);
- effecting and carrying out contracts of insurance;
- effecting and carrying out regulated mortgage contracts; and
- establishing and operating a collective investment scheme.

6.6 **Applying for FSA authorisation**

Under FSMA there is a single authorisation process for all types of firms or persons who wish to carry on regulated activities in the UK. A person becomes authorised by applying to the FSA to obtain a "permission" to carry out one or more specific regulated activities. When granting permission the FSA must ensure that 'threshold conditions' are complied with. These include conditions relating to the legal status of the applicant, the location of its offices, the applicant's resources and, generally, that the applicant is a fit and proper person having regard to all the circumstances.

Application for FSA authorisation is made by using the FSA application pack which is split into three sections. Part A contains forms about the applicant, Part B contains forms about other persons (e.g. controllers and key individuals) and Part C contains explanatory notes. Further details/notes on the application pack can be provided upon request.

6.7 **Time for authorisation process**

By statute, the FSA has six months in which to consider a properly completed application form. We understand, however, that their current service standard is for authorisation applications to be processed within three months.

6.8 **FSA approved persons regime**

In addition to the application to become an FSA approved entity, there is a separate, but related application required for any individuals who will be carrying out the critical functions of the business, known as 'controlled functions'. Those persons who need to seek approved persons status include both executive and non-executive directors, and senior managers, amongst others. These persons must be approved as 'fit and proper' by the FSA before they can take up their position at an authorised firm, and hence these individuals are referred to as 'approved persons'. These requirements apply both when establishing a business, and also at all relevant times after the FSA has authorised the firm, such as when a new director is appointed. Any change to the information supplied to the FSA must be updated promptly. These FSA requirements are in addition to the standard Companies House filing requirements set out under company law.

For advice or further information about any aspect of financial services law and practice please contact Philip Morgan, partner in the London office on + 44 (0) 207 360 8123 or by email on philip.morgan@klgates.com

7. **BUSINESS TAXATION**

Note: Tax law and rates of tax are liable to change at short notice. Advice should always be taken before implementing any specific proposals.

7.1 **Corporation tax - when UK tax is due on worldwide profits and gains**

UK tax resident companies are liable to UK corporation tax on their worldwide profits, including capital gains. A company is UK tax resident if:

- it has been incorporated in the UK since 1988; or
- its central management and control is exercised in the UK.

Therefore, for a company which is incorporated overseas, the test is whether it is centrally managed and controlled from the UK, in other words whether the policy and strategic decisions are made in the UK. Since these decisions will generally be made by the company's board or its equivalent, the constitution and place of board meetings (and equivalent meetings) can have great importance. But even if central management and control are not exercised in the UK, there may still be exposure to UK corporation tax if the company is carrying on a trade in the UK.

7.2 **Corporation tax - when UK tax is due on UK profits and gains**

Overseas companies trading **in** (as opposed to **with**) the UK through a permanent establishment are liable to UK corporation tax on profits attributable to the permanent establishment.

Capital gains of overseas companies are similarly liable to UK corporation tax if they arise on assets situated in the UK which are used for the purposes of the trade of the permanent establishment.

There are two bases upon which a company can have a permanent establishment. The first basis is where there is a fixed place of business through which the company's business is wholly or partly carried on. The second basis is where the company's business is carried on by an agent acting on the company's behalf.

The non-resident trading through a permanent establishment will be taxed in the UK on the profits which the permanent establishment would have made if it were a separate and distinct enterprise, engaged in the same or similar activities, under the same or similar conditions, dealing wholly independently with the rest of the non-resident company of which it is a part. In calculating these profits it will be assumed that the permanent establishment has:

- the same credit rating as the non-resident company of which it is a part;
- equity capital equal to that which it would have needed to operate as a separate subsidiary; and
- loan capital not in excess of that which it would have had if it had that amount of equity capital.

The general principles of UK taxation may, however, be overridden by the terms of an appropriate double tax treaty between the UK and the country of the non-resident company, which may reduce the circumstances in which tax is chargeable and also limit the profits on which tax is payable.

A company with a limited representative office presence in the UK, i.e. one which acts as a marketing/customer information centre (but does not conclude any contracts), will generally not be regarded as UK resident for UK tax purposes. Whether its activities are sufficient to constitute a permanent establishment in the UK depends on the facts. Staff may need to be given specific guidelines, setting out what their authority is, to reduce such a risk as much as possible.

Specifically, in the case of the US/UK double tax treaty, a permanent establishment does not include a fixed place of business used solely for the storage, display or delivery of goods, for collecting information or for advertising or similar activities which have a preparatory character. Consequently, such a fixed place of business should not be subject to tax in the UK.

7.3 **Treatment of a permanent establishment of a non-resident company**

Subject to the terms of any applicable double tax treaty:

- trading income directly or indirectly attributable to the permanent establishment is chargeable to UK corporation tax;
- income from property or rights used or held by the permanent establishment will be subject to UK corporation tax; and
- capital gains arising on the disposal of assets in the UK which are used for the purposes of the trade, or acquired or held for the purposes of the permanent establishment, will be subject to UK corporation tax.

The profits of the UK permanent establishment may also be taxable in the country of the non-resident company of which the enterprise is a permanent establishment but

credit may be obtained, in respect of UK tax paid, by the non-resident company. Local advice would have to be taken.

7.4 **The basic principles of UK corporation tax**

The basic principles of UK corporation tax are as follows:

- a company pays corporation tax at a single rate (30 per cent for the financial year commencing 1 April 2006) on all its profits, whether income or capital gains, and whether distributed or not;
- a reduced "small companies" rate of 19% applies to companies with taxable profits of £300,000 or less for the financial year commencing 1 April 2006 and marginal relief is available where profits are between £300,000 and £1,500,000; and
- a UK resident company is no longer obliged to account for advance corporation tax ("ACT") on dividends and other qualifying distributions.

7.5 **UK tax deductions and reliefs**

In general no deduction is allowable under UK tax law for capital expenditure or depreciation charges as shown in the accounts although deductions are available for expenditure on goodwill and IP incurred in line with their accounting treatment (or alternatively at a fixed rate), subject to certain conditions being met. However, a prescribed form of depreciation is available (known as capital allowances) based on capital expenditure incurred on eligible assets. Capital allowances can be claimed by a UK permanent establishment or a UK resident subsidiary.

A number of uses are available for trading losses of a UK company, which can be offset against current year profits and gains, carried forward to set against future profits of the same trade or, to a limited extent, carried back (subject to certain qualifications). The losses may be offset on a group basis (defined as a parent company and all its 75 per cent subsidiaries) where the losses are surrendered by one group member to another to set against its taxable profits. UK resident companies and companies carrying on a trade in the UK through a permanent establishment may claim group relief from another UK company. Losses of a UK permanent establishment of an overseas company may, in certain circumstances, be available for surrender as well, as may certain losses of a foreign subsidiary which is either resident in the European Economic Area or has incurred losses in a permanent establishment in the European Economic Area.

Capital losses may be set off only against capital gains arising in the same or subsequent years. An existing UK tax group may be able to make use of the losses but legislation prohibits a purchaser from using them.

Where early losses are anticipated, consideration should be given to establishing a permanent establishment in the UK; those losses may then be available to set against the profits of the overseas company (subject to local law). The permanent establishment may then be incorporated once it becomes profitable. Alternatively, if there are companies in place which could make use of the losses, pursuant to UK legislation, consideration may be given to surrendering the losses to those companies. The advice of your accountants will be required in connection with this.

Subject to certain limitations (usually applicable for transactions between related parties) interest, royalties and management charges are fully deductible.

7.6 Trade between parent group and the UK business

The general rule for tax purposes is that transactions between the parent of the group and its UK subsidiary (or UK permanent establishment) must be at arm's length and, as such, must reflect what would be charged for identical goods and services provided by a third party. The UK authorities have the power to adjust transactions for UK tax purposes to reflect an arm's length basis, so possibly increasing the UK tax bill. This is known as "transfer pricing".

7.7 Administration

A company must file a corporation tax return with supporting documentation such as accounts, 12 months after the end of each accounting period. However, payment of tax is required 9 months after the year end, with interest and penalties payable on any amount eventually agreed to have been overpaid or underpaid. Therefore, in practice a computation of the tax liability will have to be carried out prior to these deadlines. In addition, subject to certain exceptions, companies with profits (generally) in excess of (currently) £1,500,000 will have to pay tax in 4 instalments (i.e. quarterly accounting).

7.8 Value added tax

VAT is a consumer expenditure tax levied on the supply of most goods and services by VAT registered users. VAT is also levied on the value of goods imported into the UK and certain imported services.

The current standard rate of VAT is 17.5 per cent, but some supplies are zero-rated supplies (i.e. VAT is charged at zero per cent) or are charged to VAT at the lower rate

of 5% or are exempt supplies. The vast majority of business transactions fall within one of the supply categories.

VAT registration is compulsory for individuals, partnerships and companies (including branches of overseas companies) where business turnover of taxable supplies (excluding exempt supplies) is expected in the following 30 days to exceed the VAT threshold (£61,000 from 1 April 2006) or has done so in the previous 12 months. Registered businesses must add VAT at the appropriate rate to their sales and are (generally) required to submit quarterly VAT returns to HM Customs & Excise. Each return shows VAT charged on sales and acquisitions from the EU, less VAT suffered on purchases of goods and services (including imports and EU movement of goods). A VAT registered trader can reclaim VAT on supplies made to it unless those supplies are attributable to an exempt supply for VAT purposes.

7.9 **Other taxes**

Customs duties

There are three main types of duties: CAP levies (on agricultural and food products imported from outside the EU), excise duty on excise goods (eg tobacco products, hydrocarbon, oils and alcohol products) and ad valorem duty (on goods imported into the UK). The latter is the most commonly encountered and is charged as a percentage of the dutiable value of the imported goods. All goods imported into the UK must be declared to HM Revenue & Customs and an entry form must be completed showing full details. There are a number of ways in which import duty can be reduced or payment deferred. In addition, a large number of deductions and reliefs are available dependent on the country of origin and type of goods imported into the UK.

Stamp duty

Since 1 December 2003 stamp duty has broadly been limited in scope to transfers of shares and securities, in relation to which duty of 0.5 per cent applies. Documents transferring shares in UK companies are subject to stamp duty wherever they are executed.

Stamp duty land tax now applies to transactions in UK land. The rules are complex and specific advice should be taken at the time of the relevant transaction.

For advice or further information about any aspect of business tax law please contact Alison Middleton in the London office on +44 (0) 207 360 8121 or by email on alison.middleton@klgates.com

TABLE OF PRINCIPAL UK TAX RATES¹

Corporation Tax

Financial Year to	31 March 2006	31 March 2005
Full rate	30%	N/A
Starting rate	0%	N/A
0% rate limit	£10,000	N/A
marginal relief limit	£50,000	9N/400A
marginal relief fraction	19/400	23.75%N/A
effective marginal rate	23.75%	19%
Small companies rate	19%	£300,000
19% rate limit	£300,000	£1,500,000
marginal relief limit	£1,500,000	11/400
marginal relief fraction	11/400	32.75%
effective marginal rate	32.75%	19%N/A
Small company distributed profits minimum rate	19%	

¹ These rates are liable to change at short notice. Please seek specific advice from our tax department.

Stamp Taxes 0.5%*

*Rounded up to the nearest multiple of £5

Transfers of land and buildings (consideration paid)

Residential	Non-residential	Rate**
£125,000 or less	£150,000 or less	Nil
£125,001 - £250,000	£150,001 - £250,000	1%
£255,001 - £500,000	£250,001 - £500,000	3%
Over £500,000	Over £500,000	4%

**Different rates apply for residential property in designated disadvantaged areas

New leases (lease duty)

Residential	Non-residential	Rate
Up to £125,000	Up to £150,000	Nil
Over £125,000	Over £150,000	1%

Duty on premiums is the same as for transfers of land (but special rates apply where rent exceeds £600 annually).

Value Added Tax

Standard rate	17.5%
Lower rate	5%
Registration level from 1 April 2006	£61,000 pa
Deregistration level from 1 April 2006	£59,000 pa

8. **PERSONAL TAXATION**

Specific advice should always be taken before acting on anything contained in this section. Tax law and rates are liable to change at short notice. Different rules apply to trusts.

8.1 **General**

The way in which individuals are taxed in the UK will depend on whether they are:

- resident in the UK;
- ordinarily resident in the UK; and
- domiciled in the UK.

Individuals are taxed on the basis of a tax year which runs from 6 April in one calendar year to 5 April in the next calendar year.

8.2 **UK resident/ordinarily resident**

An individual will be regarded as resident in the UK in a tax year if:

- he spends a total of 183 days or more in that tax year in the UK; or
- either
 - it is clear at some point in that tax year that he will spend an average of 90 days or more per tax year in the UK over a five year period, or
 - over the preceding 4 tax years he has spent an average of 90 days or more per tax year in the UK.

Strictly an individual is taxable as a UK resident for the whole of a tax year if resident in the UK for any part of it. However where a person becomes or ceases to be resident in the UK in the course of a tax year, income tax and capital gains tax liabilities may (by concession) be apportioned and calculated on the period of actual residence during that year.

The test of ordinary residence is less precise than for residence and usually depends on habitual residence. With some exceptions individuals who are either resident or ordinarily resident in the UK are taxed on the same basis.

8.3 **Domicile**

Every individual is deemed to have a domicile at all times. This is distinct from nationality or residence. A person can only have a domicile in one jurisdiction at any one time. Strictly, domicile is defined by reference to a jurisdiction and not a country (for example, to England and Wales or Scotland or Northern Ireland (which have separate legal systems) rather than the UK, or to a state of the US rather than the US). However UK tax legislation refers to domicile in the UK rather than its constituent jurisdictions.

Broadly speaking, a person's place of domicile is the jurisdiction in which he intends to stay or to which he intends to return to live permanently (that is the place that he regards as his permanent home). This is a question of fact.

Whilst a child is 16 or under he will have a domicile based on that of his parents.

Normally someone coming to the UK from abroad can retain their foreign domicile provided they have an intention to leave the UK and return to their place of domicile on some clearly foreseen and reasonably anticipated contingency. The retention of a foreign domicile can have substantial UK tax advantages provided that that person's affairs are structured correctly.

For Inheritance Tax purposes only, a person will be deemed domiciled in the UK if he is not otherwise domiciled in the UK and has been resident in the UK for a substantial period of time. A person may also retain a domicile in the UK for a period after he has left the UK. This is discussed further below.

Aside from tax issues, a person's domicile will affect the succession law which applies to his property, and how his will must be drawn up.

8.4 **Income tax**

This is a tax on an individual's income and profits, such as income from employment, from a trade or profession, and from investments. The current rates are set out below.

A person who is resident in the UK for a tax year will be subject to UK income tax on income that arises anywhere in the world during that tax year.

Notwithstanding this basic rule, in certain circumstances income which arises outside the UK and the Republic of Ireland from certain sources (such as overseas pensions, an overseas trade, profession or vocation, or overseas investment income including foreign dividends and interest) will only be taxed if it is brought into the UK. This is

called the "remittance basis" of taxation and such a payment is referred to as a "remittance".

Earnings from employment of a non-UK domiciled individual are taxed as follows:

- If a person is both resident and ordinarily resident in the UK, earnings from duties performed wholly overseas for an employer which is also resident outside the UK and the Republic of Ireland will only be taxed in the UK on the remittance basis.
- If a person is resident but not ordinarily resident in the UK, all earnings from duties performed wholly overseas, irrespective of the residence of the employer, will only be taxed in the UK on the remittance basis.
- All other employment earnings whether for duties outside or inside the UK are taxable whether remitted or not

With careful planning it is possible to convert income arising in one year into capital in a subsequent year so that it can be brought into the UK free of tax.

A person who is neither resident nor domiciled in the UK will not be subject to income tax on income arising outside the UK, but will be subject to UK tax on any income arising in the UK on general principles. However:

- the terms of a double tax treaty may override this; and
- UK income from investments (other than land) and bank deposits will only be liable to UK income tax to the extent that it has suffered any UK withholding tax and not further.

8.5 **Capital gains tax ("CGT")**

This is a tax on an individual's chargeable gains (less allowable losses) from the disposal of assets made during a UK tax year. Each person has an annual allowance, and chargeable gains made in a tax year up to this amount are exempt from tax. Chargeable gains which exceed the annual allowance are added to the individual's income for that tax year to calculate the tax due.

Where an individual gives away an asset or sells it for less than market value to a connected party, this is usually treated as a disposal made at market value. So CGT may be due even if the individual has not received any proceeds for the disposal.

A person who is resident in the UK is subject to CGT on gains realised on the disposal of assets situated anywhere in the world. However a person who is resident but not domiciled in the UK will only be subject to CGT if he brings into the UK the proceeds of sale of assets located outside the UK.

There a number of reliefs which apply to reduce or defer a liability to CGT. In particular:

- any gain arising on the disposal of a property that has been that person's main or only residence during the period of ownership will not be subject to CGT.
- where a business asset has been held for at least two years, and has during all the relevant period of ownership been a business asset, 75% of the gain will be exempt from CGT;
- in certain circumstances where one asset is exchanged for another a gain can be deferred until a subsequent disposal; and
- there is no CGT payable on a transfer of assets from one spouse to another.

8.6 **Inheritance Tax ("IHT")**

IHT is payable on a person's death by reference to the value of assets owned at his death together with assets given away in the preceding 7 years. IHT also applies to certain lifetime gifts and certain assets held on trust.

A person domiciled in the UK will be subject to IHT on the value of assets he owns wherever they are located. A person not domiciled in the UK will only be subject to IHT on the value of assets he owns which are located in the UK. The terms of a double tax treaty may override these rules.

- A person will be deemed to be domiciled in the UK for IHT purposes if he has been resident in the UK for any part of 17 out of the last 20 tax years.
- Similarly where a person has been domiciled in the UK and subsequently becomes domiciled outside the UK he will be deemed domiciled in the UK for a further 3 years from the date on which he becomes domiciled outside the UK.

The main exemptions from IHT are:

- Gifts of up to £3,000 in any year. If this allowance is not used then it may be carried forward for one further year only.

- Certain small gifts up to £250 per year. Greater amounts can be given as marriage gifts.
- Gifts to a UK charity or to a spouse (although there is a restriction where a UK domiciled spouse makes a gift to a non-UK domiciled spouse).
- Gifts of business property, provided that the property meets the relevant requirements.

Having discounted any exempt gifts, tax is calculated in two bands.

- The first band comprises aggregate value up to £285,000. This amount increases each tax year. The tax rate for value within this band is 0%, and so it is known as the "Nil Rate Band". Effectively therefore transfers within the Nil Rate Band are tax free.
- The second band comprises all value over the Nil Rate Band. The tax rate for value in this band is 40%. Where tax is payable during a person's lifetime this will be charged at 20%.

8.7 **Double Taxation Agreements**

The UK has entered into a considerable number of double tax treaties with other countries. The object of such treaties is to prevent tax being charged (or provide relief where it is charged) on the same income, gains and assets both by the UK and the foreign state concerned. Not all treaties contain identical provisions, and each source of income or gain or form of assets must be looked at separately to determine how it will be taxed.

8.8 **Compliance**

The UK tax system collects much of its tax from individuals through a system of withholding taxes.

- For those who have no additional tax to pay, there is no requirement to make an annual return of their income and gains.
- Those who do have an additional tax liability above that deducted at source are obliged to file an annual tax return and pay the additional tax due. The deadline for this is 31 January following the end of the tax year. Those who fail either to file a return or to pay the tax that is due will be liable for interest and penalties.

For advice or further information about any aspect of UK tax law please contact one of the tax partners in the London office. Their names and contact details are available on the K&L Gates website.

TABLE OF MAIN INCOME AND CAPITAL GAINS TAX RATES

1. Annual personal tax free allowance

Year to	5 April 2006	5 April 2007
Income Tax (aged up to 65)	£ 4,895	£ 5,035
Capital Gains Tax	£ 8,500	£ 8,800

2. Rates of Tax

Year to				5 April 2006	5 April 2007
Rates of Tax				Tax Bands (£)	
	General income	Interest	Dividends		
Starting Rate	10%	10%	10%	0 - 2,090	0 - 2,150
Basic Rate	22%	20%	10%	2,091 - 32,400	2,151 - 33,300
Higher Rate	40%	40%	32.5%	Over 32,400	Over 33,300

N.B.

- (a) Interest and dividend income is generally taxed after other income.
- (b) Interest paid by UK banks will normally have tax of 20% deducted at source.
- (c) Dividend income is treated as having a tax credit of 10%, so that the dividend must be grossed up.

9. **COMPETITION LAW**

9.1 **General**

EC and UK competition laws apply to all legal entities carrying on business in the United Kingdom. These laws prohibit certain anti-competition agreements and abuses of market power, as well as regulating mergers and acquisitions to ensure they do not substantially lessen competition in any affected markets.

This section 8 briefly describes the UK's competition laws. The EC provisions are very similar, but only apply where there is an effect on trade between Member States. The UK's national competition authority - the Office of Fair Trading ("**OFT**") - has the power to apply both UK and EC competition laws, and many of the same consequences flow from a breach of either set of laws.

9.2 **Anti-competition Agreements**

Chapter I of the Competition Act 1998 prohibits agreements which have as their object or effect the prevention, restriction or distortion of competition in the UK. Such agreements, or the relevant clauses if they can be severed from the agreement, will be void and unenforceable. In addition, fines of up to 10 per cent of the parties' worldwide turnover may be imposed by the OFT.

Not all restrictive agreements will fall within the prohibition. Notably, the OFT applies an "appreciability" test so that minor agreements are not caught. Agreements between competitors with a combined market share of 10 per cent or less will be not generally be regarded as having an appreciable effect on competition, neither will agreements between non-competitors where each has a market share below 15 per cent. That said, price fixing and market sharing agreements will be deemed appreciable regardless of the parties' market share. In other words, even small companies need to be aware of competition laws.

For agreements which are considered to have an appreciable effect on competition, a number of "block exemptions" are available. These exempt the agreement from the Chapter I prohibition so long as certain restrictions are avoided and the parties' market share falls below a prescribed level. Block exemptions exist for vertical agreements (such as distribution and franchising agreements), technology transfer agreements (patents, know-how and software licenses), certain aviation and shipping conference agreements, and others.

Individual exemptions also apply where the benefits of an agreement to the economy and to customers outweigh its detrimental effect on competition. Agreements cannot be notified for approval, so legal advice is required as to whether an agreement will

merit an exemption. Ultimately the issue is one for the competition authorities and courts to decide.

9.3 **Abuses of Dominance**

Clearly very few companies enjoy market power at an early stage of their development. However, for those companies that do become "market leaders", special attention is needed to avoid being found to have infringed the Chapter II prohibition of the Competition Act (which prohibits the abuse of a dominant position).

A dominant position will arise where a company enjoys a market share of 40 per cent or more, although other factors must also be considered.

An abuse of dominance may arise in many ways, but examples of the most common abuses are excessive pricing, discriminatory pricing, and refusals to supply without objective justification.

Such conduct is unlawful and void and as with the Chapter I prohibition, fines of up to 10 per cent of worldwide turnover may be levied by the OFT. Unlike Chapter I, however, no exemptions are available.

9.4 **Other consequences of infringing Chapter I and II**

An infringement will give rise to a potential claim by any third party who can demonstrate they have suffered loss as a result of the infringement. Claims may be made informally to the OFT (or European Commission) by way of complaint which the competition authority may then investigate at its own expense. Such investigations can result in a decision being taken that an infringement has taken place. Alternatively, third parties may bring a case direct to the national courts claiming damages. If the OFT has already made an infringement decision, a third party that has suffered loss may bring its claim for damages to the Competition Appeal Tribunal (a specialist tribunal set up under the Competition Act).

These opportunities for complaint or legal action are particularly relevant when seen from the perspective of the start up company that may find itself pushed out of a market by the unlawful activities of larger, incumbent players.

9.5 **Criminal Sanctions**

Under the Enterprise Act 2002, it is a criminal offence knowingly to engage in "cartel activities". Cartel activities are defined as (i) price fixing, (ii) limiting supplies or production, (iii) market sharing or (iv) bid rigging. If found guilty, individuals may be given up to five years imprisonment or an unlimited fine.

Such activities must be avoided at all costs and the OFT and Serious Fraud Office both enjoy sweeping powers of investigation should they suspect a cartel is in existence.

Finally, any infringement of UK competition law may (under the Enterprise Act) result in the disqualification of the directors of the companies involved where the individuals concerned are found to have engaged in such conduct as to make them unfit to be concerned in the management or control of a company. The OFT may apply to the Courts for such an order to be made.

9.6 Mergers

At some stage in their life, most corporate entities will merge with another, enter into a joint venture or acquire another business. In such circumstances, where a change of control has taken place, it will necessary to consider the application of merger control laws.

Large scale mergers, ie those between companies with aggregate world-wide turnover of €5 billion and EU-wide turnover exceeding €250 million, or between companies with aggregate world-wide turnover exceeding €2.5 billion but with combined turnover exceeding €100 million in three or more Member States of EU must be notified to the European Commission in Brussels (under the EC Merger Regulation "ECMR"). It is unlawful to close a transaction caught by the ECMR prior to a clearance decision having been made.

Where the ECMR does not apply, UK merger control may do so if the company or business being acquired had a UK turnover exceeding £70 million or the transaction creates or enhances a market share of 25 per cent or more in the UK. Although notification is voluntary, most parties do notify where the transaction raises any material competition issues, so as to avoid the risk of intervention by the authorities post closing. The test applied by the OFT under the Enterprise Act is whether the merger will give rise to a substantial lessening of competition in the UK. Where there is a risk that it may do so, the OFT will refer the merger to the Competition Commission for investigation. Following an inquiry the Commission will decided to clear or block the transaction or to clear it subject to conditions.

Mergers in the media, water or defence sectors are subject to additional scrutiny by relevant Ministers of State.

For advice or further information about any aspect of EC or UK competition law please contact Neil Baylis, partner in the London office on + 44(0) 207 360 8140 or by email on neil.baylis@klgates.com

10. EMPLOYING PEOPLE

This section is only intended to be an overview of the relevant law in the UK. It is not a comprehensive guide to UK law as it affects an employer. Specific advice should be sought as required.

10.1 What are the tax and national insurance implications for the company?

An employer is under an obligation to deduct income tax and national insurance from the employee's wages and will also be responsible for paying employer's national insurance contributions ("NICs") on those wages. It is usual for employers to set up a Pay As You Earn ("PAYE") system so that deductions are made automatically. A firm of accountants could assist with this.

HM Revenue & Customs has the power to fine companies who fail to comply with their PAYE obligations.

10.2 Contracts of Employment

There is a statutory requirement that an employee receives a written Statement of Terms and Conditions of Employment within two months of commencing employment. This Statement must cover certain specified areas, for example, details of pay, notice periods, duties, holidays and hours of work. The Statement must also contain a reference to the employer's disciplinary and grievance procedures (see below). As at Failure to provide an employee with a Statement in accordance with Section 1 of the Employment Rights Act 1996 can lead to an employee being awarded two to four weeks' salary.

10.3 Terms of Employment

Hours of Work

There is a statutory restriction on the number of hours that an employee can work. Employees may not on average work more than 48 hours per week. However, employers can ask that employees consent in writing to "opt-out" of the 48 hour weekly working limit. If employees opt out they must be able to "opt-in" on no more than three months' notice.

Holiday

Employees have a statutory entitlement to paid holiday of four weeks' per year inclusive of public holidays. They cannot be paid in lieu of this entitlement except on termination and cannot carry it over to another holiday year.

Pension

There is no requirement to provide a pension where an employer employs less than five employees in the UK. For employers with more than five employees, the employer must provide access to a stakeholder scheme but is not under an obligation to make any contributions to that scheme.

However, pensions law in the UK is complex and anyone establishing a business in the UK should take advice on the implications and obligations of employees.

Notice

After one month's service, an employee is entitled to a minimum of one week's notice of termination of employment. Once an employee has been employed for at least two years an employer is required to give one week's notice per complete year of service up to a maximum of 12 weeks unless the employee is guilty of gross misconduct. The employer and employee can agree to longer notice periods but not less than the statutory minimum.

If an employee is dismissed with less notice or no notice, they may have a claim for wrongful dismissal.

10.4 Minimum Wage

As at 1 March 2006, the adult rate for workers aged:

- 22 and over is £5.05 per hour;
- 18 to 21 inclusive is £4.25 per hour; and
- 16 to 17 is £3.00 per hour.

10.5 Unfair Dismissal

An employee with at least one year's service has the right to bring a claim for unfair dismissal in the Employment Tribunal (although certain claims, for example, unfair dismissal for asserting a statutory right, do not require any minimum service). An eligible employee who is dismissed can bring a claim before an Employment Tribunal within three months of the date of dismissal.

In order to successfully defend such a claim, the employer has to demonstrate that it has a fair reason for dismissal and that it has followed a fair procedure.

There are five fair reasons: redundancy, misconduct, capability, that it would be in contravention of a statutory enactment to continue to employ the employee (for example, if they did not have a work permit) or some other substantial reason. What constitutes a fair procedure varies in each case.

If the employee succeeds in his or her claim for unfair dismissal, then he would be entitled to a basic award and a compensatory award of damages. The basic award is calculated by multiplying one week's pay (currently capped at £290) by every complete year of service. The week's pay is also multiplied by a factor of 1½ for each year in which the employee is 41 or over.

The compensatory award is designed to compensate the employee for loss of income following the dismissal and will be calculated on the basis of the value of the employee's net monthly salary and benefits for each month of unemployment following the dismissal until the employee succeeds in finding alternative employment. The compensatory award is currently capped at £58,400

10.6 **Discrimination**

An employee has the right not to be discriminated against on the grounds of race (including colour, nationality or ethnic origin), sex, disability, religion, belief, sexual orientation or, as of 1 October 2006, age. This applies when offering employment, in the course of employment or in respect of its termination. This is a complicated area of the law which is outside the scope of this note.

Damages for discrimination are uncapped and include an award for injury to feelings where applicable.

10.7 **Age Discrimination**

As of 1 October 2006, direct and indirect discrimination on the grounds of age will be prohibited in the UK under the Employment Equality (Age) Regulations 2006. Under the Regulations the main changes to the law are:

- Direct and indirect discrimination will be unlawful unless it can be objectively justified. Justification may be demonstrated if the employer can show that they have a legitimate aim and that it was an appropriate and necessary means of achieving that aim;
- An employer must give at least 6 months' notice to an employee before their intended retirement date and must inform the employee of their "right to request" the ability to work beyond the intended retirement date;

- Employees will have the right to request the ability to work beyond the age of 65 or any other retirement age set by the employer and employers will have a duty to consider such requests;
- There will be a national default retirement age of 65 years and compulsory retirement before this age will be unlawful unless objectively justified;
- The upper age limit for unfair dismissal and statutory redundancy rights will be removed.

The penalties for failure to comply with the new requirements will be significant as, in line with other types of discrimination law, compensation for age discrimination will be uncapped.

10.8 **Redundancy**

Once an employee has completed two years' continuous employment, he or she is entitled to a statutory redundancy payment if he or she is dismissed 'by reason of redundancy'. A redundancy situation will arise where:

- an employer has stopped or intends to stop carrying on the business either altogether or, in the place where the employee is employed; or
- there is no longer a requirement for an employee or employees to carry out work of a particular kind.

The amount of a statutory redundancy payment is calculated according to the length of the employee's continuous period of employment, age and pay expressed as a weekly figure (currently capped at £290). If the employer fails to make a redundancy payment, the employee can bring a claim before an Employment Tribunal.

Where an employer proposes to dismiss 20 or more employees as redundant at an establishment within a period of 90 days or less, the employer must consult with 'appropriate representatives' of affected employees (either a recognised trade union or elected representatives) and notify the Secretary of State.

10.9 **Maternity Leave**

A pregnant employee is entitled to a minimum of 26 weeks' 'ordinary' maternity leave regardless of how long she has worked for the employer. If the employee has been employed for at least 26 weeks at the start of the 15th week before the expected week of birth, she will also have a right to take 'additional' maternity leave for a further 26 weeks commencing at the end of the 'ordinary' maternity leave period.

A pregnant employee has the right to Statutory Maternity Pay ("**SMP**") if she has been continuously employed by her employer for at least 26 weeks (calculated back from 15 weeks before the due date for the birth). SMP is paid for 26 weeks from the time the employee starts maternity leave and is payable at two rates. For the first six weeks the employee is entitled to 90 per cent of her weekly earnings (with no upper limit) and for the remaining 20 weeks £106 or 90 per cent of weekly earnings if this is less than £106. Additional maternity leave is unpaid.

An employee who has taken ordinary maternity leave has the right to return to the same job on the same terms and conditions as those under which she was employed before her absence.

An employee who returns to work after additional maternity leave is also entitled to return to the same job on the same terms and conditions as if she has not been absent. However, in this case, if it is not reasonably practicable for her employer to offer the employee her original job, she is entitled to be offered another suitable alternative position. The employee's contract of employment may provide for an enhanced maternity package.

10.10 **Paternity and Parental Leave**

Employees (whether male or female) who have one year's service are entitled to take time off work to look after a child or make arrangements for its welfare. This applies to all children born on or after 15 December 1994. The right is to take up to 13 weeks' unpaid leave per child up to the child's 5th birthday (or 18 weeks' leave during the first 18 years of the child's life if the child is disabled). No more than four weeks may be taken in any one year. Employers are under an obligation to maintain records of leave taken by an employee.

In addition, there is a statutory right for employees to take time off for dependants which gives all employees, regardless of service, a right to take a reasonable period of time off to deal with an emergency involving a dependant. Again, this is unpaid.

There is also an entitlement to two weeks of paid paternity leave.

10.11 **Statutory Sick Pay**

Employees who pay National Insurance contributions are entitled to be paid statutory sick pay from the employer for the first 28 weeks of absence in any period of three years. The first 3 days of absence do not count; the employee only becomes entitled to statutory sick pay upon the 4th day of absence. The current rate of statutory sick pay is £68.20 per week.

Please note that there is no obligation on an employer to pay the full amount of the employee's salary during any period of sickness absence unless the contract provides otherwise.

Employers are obliged to keep records of sickness absence and the amounts of statutory sick pay paid.

10.12 **Health and Safety**

An employer has a duty to ensure, so far as is reasonably practical, the health, safety and welfare at work of its employees. This includes ensuring that the workplace is safe and without risk to health, that safe systems of work are set and followed, providing adequate welfare facilities and providing employees with information, instruction, training and supervision necessary for their health and safety.

The Health and Safety Executive provides further helpful information regarding an employer's duties under health and safety law and their information line is tel: 09701 545500.

10.13 **Data Protection**

Information which an employer stores about its employees will constitute "personal data" under the Data Protection Act 1998 (which is discussed in further detail in section 12 of this guide). In summary, it is legitimate under the Act for an employer to store and to process personal data to the extent that such information is necessary for the purposes of the employment. If data is not necessary for the employment, the employer may only store it with the data subject's consent. The data must always be kept up-to-date, secure and may not be transferred outside the EU unless certain conditions are met. The employee has rights to access and to correct their data.

Any request to access personal data must be in writing. Once an employer receives a request it must respond within 40 calendar days. The employer can charge up to £10 for producing copies of the information held.

10.14 **Disciplinary and Grievance Procedure**

Where an employer is contemplating dismissing an employee or taking other relevant disciplinary action (not including warnings or suspension on full pay), it must follow a basic statutory procedure that must include:

- sending the employee a statement setting out the reasons why the employer is contemplating disciplinary action or dismissal together with the basis of those reasons;

- holding a meeting to discuss the matter;
- informing the employee of the decision; and
- holding an appeal meeting if the employee requests an appeal.

Failure by the employer to follow this procedure may result in an Employment Tribunal finding any subsequent dismissal to be procedurally automatically unfair and damages can be increased by between 10 per cent to 50 per cent.

Where an employee raises a grievance, he or she must set out the grievance in writing including the basis for the grievance. The employer must invite the employee to a meeting to discuss the grievance and the employee must be informed of the right of appeal and a further meeting held if requested. In certain circumstances, an employee will not be allowed to lodge an Employment Tribunal claim (for example, for constructive unfair dismissal) unless the employee has raised a grievance under this procedure and a period of 28 days has elapsed.

10.15 **Work Permits**

Most overseas workers (other than EEA nationals) who wish to be employed in the UK must first possess a work permit issued by the Home Office. Applications for work permits are handled by Work Permits (UK), part of the Home Office Immigration and Nationality Directorate, and in most cases the work permit is dealt with in one or two weeks. Work permits will usually only be issued if:

- The position is suitably senior, such as for a senior executive or senior manager or the role requires substantial relevant specialist experience;
- The candidate is suitably experienced;
- The employer has been unable to find anyone locally, or has no realistic prospect of doing so;
- A genuine vacancy exists and that the vacancy cannot be filled by a UK or other EEA national.

Unless the candidate has been employed in an overseas office of the company, the position will normally have to be advertised within the UK and EEA before an application can be made to fill the role with a foreign national. This does not apply when the position is at board level and attracts a salary in excess of £50,000 or the position is a high level executive one linked to inward investment of over £250,000 in the UK.

For advice or further information about any aspect of EC or UK employment law please contact Paul Callegari, partner in the London office on + 44(0) 207 360 8194 or by email on paul.callegari@klgates.com

11. EMPLOYEE SHARE PLANS

11.1 General

Providing employees with salary packages combined with incentives linked to their performance and the performance of the business is often critical to a company's ability to attract and retain employees. The use of share based incentive arrangements is generally seen as an effective way to offer performance linked incentives and to align the interests of the employees and the company's shareholders.

In principle, the acquisition of shares by employees is subject to income tax under UK tax legislation by reference to the difference (if any) between the market value of the shares at the date of acquisition and the amount paid for the shares. If the shares are "readily convertible assets" (broadly, marketable) the income tax must be accounted for through the pay as you earn ("PAYE") withholding tax system and national insurance contributions ("NICs" - UK social security) are payable. Employer's NICs are payable at 12.8% of the amount that is subject to tax (although it is possible in many circumstances to transfer this liability to the employee, which often has cash flow and accounting advantages for the employer).

However, UK tax legislation permits certain incentive plans which are approved by HM Revenue & Customs to provide tax/NICs relief on the acquisition of shares as long as various conditions are met. "**Approved Plans**" will normally give rise to a capital gains tax charge on the sale of the shares which can be as low as 10% where shares have been held for at least two years. The following Approved Plans are commonly implemented in the UK:

- (a) Company Share Option Plans: These are standard approved share option plans which permit income tax/NICs relief on the exercise of options to acquire shares with an aggregate value at the time of option grant of up to £30,000. Capital gains tax is charged on disposal of the shares acquired through option exercise on the difference between the sale proceeds and the option exercise price. Options qualify for tax relief if they are held for three years after grant or are exercised within six months of cessation of employment for various "good leaver " reasons. Non-UK parented groups often introduce a UK Sub-Plan which effectively implements the company's parent plan as amended to comply with the CSOP legislation in order to save on employer's NICs costs;
- (b) Save as you earn plans: These are option plans linked to a savings contract, whereby employees save up to £250 per month for three, five or seven years and the savings are used to pay the option exercise price. Options can be granted with a discount of up to 20% to the market value of the shares at the date of grant. If the options are not exercised, the savings are returned to the

employees with tax-free interest, meaning that these plans are in many ways a "no lose" investment for employees. Generally these plans are only viable if there are a large number of participants (say, more than 100);

- (c) Share Incentive Plans: These are share award/purchase plans whereby free shares with a value of up to £3,000 can be given to employees and/or employees can purchase shares with a value of up to £1,500 per year from pre-tax income and in addition the company can award matching shares on any basis up to a ratio of 2:1 (i.e. up to a value of £3,000). The shares are held in a trust and are acquired free of income tax/NICs as long as they remain in the trust for at least five years after acquisition. These plans can be complex especially where a range of purchased, matching and free shares are used and are generally more expensive to implement and administer than other approved plans:

- (d) Enterprise Management Incentive ("EMI") share option plans: These are share option plans that allow companies with gross assets of less than £30 million which carry on certain qualifying UK trades to grant options to employees who spend the majority of their working time working for the company. An employee can hold EMI options over shares worth up to £100,000 valued at the date of grant. The total value of shares in respect of which EMI options can be granted must not exceed £3 million. Income tax charges arise on the exercise of EMI options if the exercise price of the option is lower than the market value of the shares at the date of the grant of the option or if certain disqualifying events occur. One significant benefit of EMI options is that for capital gains tax purposes, the shareholder is treated as acquiring the asset from the date that he acquired the options rather than the date he acquires the shares, which means that the most beneficial capital gains tax treatment can be obtained at a much earlier stage where shares are acquired pursuant to the exercise of these options.

The most commonly used "unapproved" share incentive arrangements in the UK have traditionally been share options granted with an exercise price equal to the market value of the shares as at the date of grant. These options are subject to income tax/NICs on exercise, with the shares acquired through option exercise being subject to capital gains tax on disposal. However, since the introduction of international accounting standards in the UK, companies have been increasingly looking at other arrangements which require fewer awards to be made to create equivalent value in order to reduce accounting charges and shareholder dilution. These may take the form of the award of shares which are subject to forfeiture (conditional/restricted shares) or nil-cost option arrangements (deferred shares/restricted stock units) or share appreciation rights.

Many private companies use phantom option plans which provide cash payments by reference to the increase in value of a company's shares or other assets and can be easier to operate when there is no real market for the company's shares. Alternatively, many private companies also use Employee Benefit Trusts (discretionary trusts designed to provide benefits to employees, their relatives and dependants), which can be used to create a market for the shares.

For advice or further information about any aspect of Employee Share Plans in the UK, please contact Ian Fraser, partner in the London office on + 44(0) 207 360 8268 or by email on ian.fraser@klgates.com.

12. **LAND**

12.1 **Introduction**

There are no restrictions on the acquisition, ownership or disposal of UK land by overseas companies or individuals and property can be freely rented (leased) or bought for use or as an investment.

Property in England and Wales is either freehold, commonhold or leasehold. There are two main types of leasehold property:

- where the lease provides for commercial rent to be paid, which also may be subject to an initial premium (usually shorter leases); or
- where the lease provides for a nominal annual rent and for which there is an initial premium, which may well equate closely to the equivalent freehold cost (usually longer leases of 50 years or more).

Whilst regulations prescribe a number of standard forms for freehold and commonhold transactions, there is very little standardisation of lease documents.

Legal advice should always be obtained as to the form of documents and the necessary steps to be taken to ensure that legal title is properly obtained.

12.2 **Stamp Duty Land Tax**

Stamp duty land tax is generally payable by the purchaser on the acquisition of land, being principally 4% on land acquired for £500,000 or more. Leases are stamped by reference to their net present value. There is a complex formula to ascertain this value, prescribed by HM Revenue & Customs from time to time.

12.3 **Land registration**

Apart from certain short term leases, land ownership must be registered at the Land Registry which is the government agency responsible for maintaining such records. A fee is payable according to the value of the land. Mortgages must also be registered if they are to have full effect.

12.4 **Security of tenure**

Where premises are occupied in the carrying on of a business, the occupier may have statutory rights to take on a new lease when an existing lease expires. Detailed procedural steps need to be taken pursuant to the Landlord and Tenant Act 1954 and it

will be necessary to assess the market rent at the time of the renewal so that the rent on the new lease is at the prevailing market rent. Otherwise, many of the terms of the old lease will apply to the new lease.

12.5 **Physical condition**

It is extremely rare for a vendor or landlord to warrant that the physical condition of a property is satisfactory or suitable for its use. A structural survey by a properly qualified surveyor is usually appropriate in order that a purchaser or tenant may be fully aware of any potential liabilities in this connection before being contractually committed to take the property.

For advice or further information about any aspect of land law please contact Steven Cox, partner in the London office on +44 (0) 207 360 8213 or by email on steven.cox@klgates.com

13. **PLANNING AND ENVIRONMENTAL ISSUES**

13.1 **Planning laws and restrictions**

In the UK the use and development of land is controlled by a well developed system of town and country planning regulation. The planning status of a property can have a significant effect on value. Part of the due diligence to be undertaken before agreeing to acquire any property (whether freehold or leasehold) should include a check on whether the property benefits from planning permission or existing use rights for its proposed use.

For development properties, the development plan will give an indication of what, if any, development might be acceptable in the future, but there are many factors to take into account and a careful appraisal will be required. It can take many months or even years to secure planning permission for complex proposals, although straightforward applications have a target of 8 weeks for determination. Planning permission is not always granted, and can be refused, and local planning authorities have wide ranging enforcement powers in respect of breaches of planning control.

In addition to planning controls there are separate and parallel systems of controls for buildings of special architectural or historic interest (listed buildings), ancient monuments, buildings in conservation areas, preserved trees, advertisements, works to highways and designations relating to flora and fauna, open land (green belt), and other matters upon which detailed advice should be sought.

13.2 **Environmental issues**

The UK's industrial history has left a significant legacy of contaminated land and water. Contamination is dealt with by a regime which focuses on the 'polluter pays' principle but is subject to complicated rules and exceptions, that can catch out innocent owners and occupiers. Clean-up costs can be significant and statutory action can be taken by the regulators to secure remediation. Hence a check on the history of a site, and the likelihood of it being contaminated is, as a minimum, an essential part of any acquisition due diligence.

Stringent rules are also imposed on those in control of premises to manage risks associated with asbestos and other health and safety risks, and to provide access for the disabled.

Consents are needed for a wide variety of industrial processes and these are often granted subject to conditions regulating their operation. Non-compliance with the conditions of a consent can result in enforcement action or prosecution.

Environmental issues are becoming increasingly pertinent for companies in the context of day-to-day operations or acquisitions of other businesses, and there is detailed and extensive regulation, much of it originating from the EU, dealing with waste, packaging, use of solvents, ozone depleting substances, hazardous substances, major accident hazards, waste electrical equipment, environmental liability and other issues.

For advice or further information about any aspect of environmental law please contact Sebastian Charles in the London office on +44 (0) 207 360 8205 or by email on sebastian.charles@klgates.com

14. CONSUMER PROTECTION AND INSURANCE

14.1 Sales of goods and services

UK legislation protects consumers in requiring that goods are of satisfactory quality, fit for purpose and as described. Services are required to be performed to standards of reasonable care and skill. The Unfair Terms in Consumer Contracts Regulations 1999 require that standard term contracts must be fair in order to be enforceable.

14.2 Consumer Credit

The Consumer Credit Act 1974 requires many businesses which offer goods or services on credit or which lend money to consumers to be licensed by the UK's Office of Fair Trading.

14.3 Advertising

The Control of Misleading Advertisement Regulations are designed to protect consumers from misleading advertisements. Businesses also need to be aware of the requirements of the Trade Descriptions Act 1968 in relation to goods and services. All pricing must comply with the Consumer Protection Act 1987.

14.4 Insurance

Businesses are required to take out employer's liability insurance and third party liability motor insurance. There are also non-compulsory insurances which businesses usually take out, such as insurance against fire, damage and public liability. It is also very worthwhile acquiring Directors' and Officers' cover. Companies need to ensure that the policies they purchase cover exactly what they require.

For advice or further information about any aspect of Consumer law and Insurance, please contact Laura Harcombe in the London office on +44 (0) 207 360 8186 or by e-mail on lharcombe@klgates.com.

15. **INTELLECTUAL PROPERTY**

Businesses looking to establish themselves in the UK should be aware of how best to protect their less tangible assets. The intellectual property of a business is often highly valuable. In the UK there are a number of intellectual property rights that may be protected in a variety of manners, including trade marks, patents, unregistered and registered designs, copyright and database right. Businesses should also consider whether to register UK or European specific domain names (those with .co.uk or .eu extensions). Whilst in many areas the general principles of intellectual property protection may be similar to other countries, some significant differences exist. Businesses should also exercise a certain amount of caution on entering the UK market to avoid problems created by infringing the intellectual property rights of others.

15.1 **Patents**

In order for a patent to be granted in the UK the invention must be novel, involve an inventive step and be capable of industrial application. The application procedure is complex and it is therefore vital that a professionally qualified patent agent is involved from the start. There are substantive differences between the US and European patent systems. For example, the European system takes a much more restrictive approach to the registration of business method patents and software patents.

The granting of a UK patent offers the owner a monopoly over the invention for a term of 20 years, provided that the patent is valid and that timely payment of the required renewal fees is made. Patents can provide the owner with valuable licensing rights.

Applicants may apply for either a UK patent or via the centralised European Patent Convention route. Applicants for patents under the European Patent Convention file a single application in which they must designate the contracting states in which they wish to be protected. A bundle of national patents may eventually be granted, resulting in a national registration for each of the specified states. Alternatively, it is possible to file a single international application for a patent under the Patent Co-operation Treaty. Again, the application proceeds as a bundle of national patents.

Prior to applying for a patent it is important that the invention is kept secret and confidential as a valid patent cannot be obtained if there has been a disclosure (anywhere in the world) of the invention prior to the date of the patent application.

15.2 **Trade marks**

Trade marks may be protected by registration as national marks in the UK or as Community marks which offer protection in all EC Member States, including the ten new States that joined the EC in 2004. Owners of trade marks (whether registered or

not) can also protect marks which have acquired goodwill or reputation by relying on a claim for passing off (similar to the US claim of unfair competition) against third parties making use of the mark without their consent. Passing off claims are notoriously difficult, and businesses are always recommended to obtain trade mark registrations to protect their brand names and logos. As well as traditional trade marks consisting of words and logos, it may be possible to register marks consisting purely of colours, shapes or even sounds.

Applications for UK and Community trade marks are made to the UK national and EC trade mark offices. For businesses using their brands in the EC and beyond, it may be appropriate to obtain protection via the Madrid Protocol route, which allows for a single application to designate protection in over 50 countries across Europe, the USA, and worldwide. A Madrid Protocol application results in a bundle of national registrations.

Prior to applying to register, or indeed making use of a trade mark in a new territory, a search should be undertaken to ensure the mark has not already been registered. Prior registration of the mark or any confusingly similar trade mark for the same or similar goods or services will prevent the application proceeding to a valid grant of rights and use of the mark will infringe the third party rights in the mark. Maintenance of trade mark registrations requires timely payment of renewal fees, and must be put to genuine use to prevent challenges for cancellation for non-use. Subject to those requirements, once validly registered a trade mark provides a perpetual monopoly over a mark.

A finding by the courts that there has been trade mark or passing off may result in a range of civil and criminal penalties and the courts may grant injunctions, damages or an account of profits, and order that the infringing goods be delivered up.

15.3 **Copyright**

Copyright protects original creative works including literary, dramatic, musical, and artistic works, sound recordings, films, broadcasts and typographical arrangements. Computer programs and databases may also be afforded copyright protection as original literary works. In the UK, copyright work arises automatically upon creation of the work and is not subject to any registration formalities. The period of protection by copyright is of limited duration, for instance a literary work will be protected until the expiry of 70 years from the year of the author's death.

As with the other intellectual property rights civil penalties may be imposed for infringement, including injunction, damages or an account of profits, and order for delivery up. Criminal penalties may also apply for certain types of infringement. Where a third party has independently created the same or similar work, copyright will

not have been infringed since the right is essentially limited to prevention of copying without permission.

15.4 **Database Rights**

A database is a collection of data or other material arranged in such a way that the items are individually accessible. Databases may be protected by the relatively recent stand-alone "database right" which was introduced across Europe to protect the investment made in the creation of databases of information. To be protected by database right the database must be the result of substantial investment in the creation of the database. Databases may also enjoy copyright protection if they are the result of sufficient skill and care. The stand-alone database right (as opposed to copyright in the database) lasts for 15 years from creation or publication.

The database right is infringed by extraction or re-utilisation of the contents of the database. Remedies available to the right owner for infringement of database right include injunction and damages or account of profits.

15.5 **Registered design rights**

A registered design gives the owner a monopoly over designs for the external shape, configuration and appearance of products provided they satisfy the requirements of novelty and individual character. Proof of infringement does not require copying but instead, as with trade marks and patents, registered designs offer a monopoly right enforceable even against independently created designs which are sufficiently similar to the registered design that the "infringing" design does not produce on the informed user a different overall impression to the registered design.

Again, as with registered trade marks, the application for registration may be made as a national application or through the Registered Community Design right system which offers protection of the design within the EU via a single application and registration. Protection can last for up to a total of 25 years, subject to payment of renewal fees.

15.6 **Unregistered design rights**

Unregistered design rights, as with copyright, arise automatically in original designs. Under UK law, design rights may arise from the shape or configuration of an article and may be protected provided certain criteria are satisfied. The period of protection will last for the shorter of either 15 years after the design's creation or ten years after the design is marketed. Under EU law, any design created in the EU that is new and has individual character automatically becomes protected as an Unregistered Community Design for a period of three years from the moment it is made available to the European public.

Again, infringement is only by copying of the design, so that independent development of the same/similar design will not be an infringement of the unregistered design right. An owner of the right may be awarded an injunction, damages or account of profits and an order for delivery up against an infringer.

15.7 **Licensing**

Foreign businesses looking to establish themselves in the UK should seek legal advice regarding the licensing of intellectual property rights since these rules are complex and terms of the licence agreement will need to comply with EU competition law. Note that licenses for registered trade marks, patents or registered designs should be registered with the UK Patent Office. Failure to register licences for registered rights within 6 months of entering into the licence may result in loss of the ability to claim damages if a claim for infringement of the right is made.

15.8 **Data Protection**

The Data Protection Act 1998 regulates the collection and processing of personal data in the UK and was implemented following the EU Data Protection Directive. The definition of personal data includes names and personal information relating to living, identifiable individuals. In order to comply with the Data Protection Act 1998, policies should be put in place by businesses regarding the procedure for protection and the security of data relating to employees, suppliers and customers. Businesses will need to notify the Information Commissioner with details of their processing activities. The Data Protection Act 1998 provides a right of access by the data subject to personal information relating to them and the requirement of consent for any non-obvious processing of personal data, such as for marketing purposes.

Under the Data Protection Act 1998, anyone collecting, storing or disclosing personal data must ensure that the data is:

- fairly and lawfully processed;
- obtained for specific and lawful purposes;
- adequate, relevant and not excessive;
- accurate and up to date;
- not kept longer than necessary;
- processed in accordance with data subjects' rights;

- secure; and
- not transferred to countries outside the EEA without adequate protection.

There are a number of aspects of the Data Protection Act 1998 that affect businesses in the UK. Foreign companies looking to establish themselves in the UK should seek legal advice regarding data protection to ensure compliance. In particular, there is a ban on the export of personal data out of the EEA to countries whose data protection laws do not comply with the EU standards. Significantly, this will cover many countries including the USA which will need to comply with the 'Safe Harbor' programme. Failure to comply with these requirements can give rise to significant problems in the use of data, as well as fines and other enforcement action from the UK authorities. In relation to the internet and data protection it will be necessary carefully to draft any website privacy policies of a business to ensure compliance with the Data Protection Act 1998. Further guidelines on this area by the Information Commissioner can be found at www.dataprotection.gov.uk

For advice or further information about any aspect of intellectual property law please contact Rachel Boothroyd partner in the London office on + 44(0) 207 360 8255 or by email on rachel.boothroyd@klgates.com or Dominic Bray, partner in the London office on + 44(0) 207 360 8191 or by email on dominic.bray@klgates.com

16. **INSOLVENCY**

- 16.1 The focus of this guide is on the setting up of a UK business. In the unfortunate event, however, that a company becomes insolvent or is likely to become insolvent it is essential that its directors seek immediate legal advice. Corporate recovery is one of our main areas of expertise.
- 16.2 A director's general duty is to act in the best interests of the company's shareholders. When a company is "insolvent", the directors must exercise their powers and discharge their duties with a view to minimising potential loss to creditors.
- 16.3 When faced with the insolvency or likely insolvency of the company, the directors should, therefore, consider the various rescue mechanisms and insolvency processes available under UK law and determine (with the help of professional advice) whether it will be possible to rescue the company or whether it should be wound up.
- 16.4 The main forms of rescue mechanisms and insolvency processes are as follows:

Administration

A company which is insolvent or is likely to become insolvent may be placed into administration upon the application of the company itself, its directors, a creditor or the holder of a qualifying floating charge over the company. Upon the making of an administration order, a moratorium on enforcement action against the company by its creditors becomes permanent. The company is then managed and controlled by the appointed administrator (a licensed insolvency practitioner). The main aims of administration are the rescue of the company or to effect a better realisation of its assets than liquidation.

CVA

This is an agreement between a company, its shareholders and its creditors which allows the company to continue to trade under the control of its directors but subject to the supervision of a nominee (who must be a licensed insolvency practitioner). The voluntary arrangement generally involves an agreement by the creditors to accept reduced debt repayments over a specified time period (generally up to 5 years) whilst the company continues to trade. This procedure requires limited court involvement.

Administrative Receivership

An administrative receiver is a receiver or manager of the whole (or substantially the whole) of the company's property appointed by or on behalf of the holder of any debenture secured by a charge which, as created, was a floating charge over the whole,

or substantially the whole of the company's assets. Administrative receivership is not strictly a rescue mechanism nor an insolvency process, but a form of creditor's remedy. As a result, the administrative receiver's primary duty is to seek repayment of the secured debt and not to act in the best interests of the general body of creditors.

Liquidation

In the event that a corporate rescue is not possible, an insolvent company will be placed into liquidation. Liquidation may take place following receivership or administration and involves the appointment of a liquidator who collects in and distributes the company's assets and dissolves the company. The proceeds of sale are distributed to creditors by way of dividend in a defined order of priority. Unlike an administrator, a liquidator will not continue to trade the company. There are two forms of liquidation, compulsory and voluntary liquidation. In a compulsory liquidation, the company is put into liquidation by order of the court. In a voluntary liquidation, the company may resolve to wind up the company.

16.5 Actions Potentially Giving Rise to Liability for Directors

The directors of the company should also bear in mind their own potential liability. The main types of director liability for insolvency are as follows:

Wrongful Trading

The directors of the company risk personal liability for the company's debt obligations if, having concluded (or in circumstances where they should have concluded) that the company was unlikely to avoid insolvency or liquidation, the directors of the company continued to trade that company. The director may have a defence to such a claim, if when he knew (or ought to have known) that the company was unlikely to avoid insolvent liquidation, he took every step with a view to minimising the potential loss to creditors. Only a liquidator has standing to bring wrongful trading proceedings.

Fraudulent Trading

If the directors of the company or any person knowingly carries on business with an intent to defraud creditors or for any fraudulent purpose, they risk liability for fraudulent trading. Again, only a liquidator may bring fraudulent trading proceedings. The civil sanctions for fraudulent trading is to require the director to make a contribution to the company's assets, as for wrongful trading referred to above. Unlike wrongful trading, there are also criminal sanctions of a fine and/or imprisonment.

Misfeasance

If a director of a company misapplies or retains the company's property, the liquidator, any creditor or member of the company may apply to the court for an order that the director compensates the company for the misfeasance. Claims for misfeasance may include not only loss to the company through misappropriation, or through improper payments such as unlawful distributions from capital or wrongful preferences, but also secret profits and other benefits obtained by directors in breach of their fiduciary duties.

Directors Disqualification

If the director of a company permits a company which is insolvent to continue trading at the unwarranted risk of creditors, this will provide a ground for a finding of unfitness pursuant to the requirements of the Company Directors Disqualification Act 1986. If the director is found to be unfit to be a director of a company, the court may disqualify the director from being a director of any company for a minimum period of two years up to a maximum period of 15 years.

16.6 Antecedent Transactions

There are several types of antecedent transactions that may be set aside by a subsequently appointed liquidator or administrator, including the following:

Transactions at an Undervalue

These are transactions entered into by the company for no consideration or consideration worth significantly less than the consideration provided by the company. Such a transaction cannot be set aside if it was entered into in good faith for the purpose of carrying on the company's business and at a time when there were reasonable grounds for believing that the transaction would benefit the company. The transaction may be set aside within two years before commencement of winding up or presentation of the petition for an administration order.

Transactions Defrauding Creditors

The Court may set aside a transaction at an undervalue designed to put assets out of reach of creditors. There is no time limit for avoidance fixed by the legislation and such claim may be brought by a liquidator, an administrator or a victim of the transaction.

Preferences

A preference is given if the company puts a creditor, or a surety or guarantor of a debt of the company, into a better position on an insolvent liquidation than he would have

been in if that thing had not been done. (For example the granting of a charge for a pre existing unsecured debt) A transaction cannot be set aside as a preference unless the company was influenced in deciding to give the preference to a person by a desire to put that person into a better position on liquidation than he would have been in if it had not been done. Such a desire is presumed where the preference was given to a connected person. The transaction may be set aside within six months before commencement of winding up or presentation of the petition for an administration order and will be extended to two years where preference has been given to a connected person.

For advice or further information about any aspect of insolvency law please contact Antony Griffiths partner in the London office on + 44(0) 207 360 8195 or by email on antony.griffiths@klgates.com

17. **FINALLY**

The structure to be used by a business seeking to establish a business in the UK is dependent on a number of legal and tax considerations and the level of business that is likely to be transacted in the UK. The above is only a brief summary of some of the key considerations. We are happy to provide more specific advice on request.

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February 2007

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