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Starting A Business In The UK

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When setting up a business in the UK it is necessary to give careful consideration to the business vehicle that will best suit a client's needs. Below is an overview of some of the key characteristics of the various ways a business presence in the UK can be established. Which approach is used will need to take account of a wide variety of factors, including the commercial risks, rewards and opportunities.

Limited Company

The standard vehicle for carrying on business in the UK is a company limited by shares (or a "limited company"), as organized under the Companies Act 1985. A UK limited company is a distinct legal entity, fully liable for its own obligations. Holders of its equity are shareholders and, absent express agreement, or extraordinary circumstances, are not generally liable for the company's obligations (except to the extent of their investment in the company).

Like corporations organized in the United States, management is largely prescribed under the Companies Act and consists of a board of directors which would generally delegate authority for day-to-day management and operation of the business to executive officers.

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In return for the advantage of limited liability, there are a number of controls imposed by the Companies Act. UK limited companies are, for instance, required to prepare audited annual accounts and an annual return, which gives a general snapshot of the company, including information on the company directors, the registered office, shareholders and share capital. Both the accounts and the return must be filed with the Registrar of Companies (sometimes called "Companies House"). The filing process is simple and inexpensive, but it does mean that the accounts are public documents. 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 maintained by the company itself.

Among other requirements under the Companies Act, limited companies are subject to maintenance of capital requirements, by which the ability to repay amounts



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invested by shareholders as "share capital" is restricted. In the UK, share capital is the risk capital of the shareholders and potential creditors can legitimately expect that it will be maintained by the company in deciding whether to lend amounts to or do business with, the company.

UK companies limited by shares can be either private or public limited companies. Most companies in the UK are private limited companies. Larger UK companies are more likely to be public limited companies. Not surprisingly, public limited companies (the names of which are required to 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. In order to become a public limited company, a private limited company must, among other things, gain the approval of over 75% of the shareholders and its issued share capital must exceed £50,000, of which at least 25% must be paid up. Private limited companies

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(the names of which are required to end with the word "limited" or "Ltd") may not offer securities to the public in the UK, subject to certain limited exceptions.

Businesses carrying on financial services in the UK are subject to additional requirements over and above those set out in the Companies Act. The Financial Services Authority ("FSA"), the UK's financial services regulator, regulates investment business, deposit-taking institutions, insurance and investment markets. The FSA also enforces the financial services regulations.

UK tax resident companies are liable to UK corporation tax on their worldwide profits, including capital gains. A limited company is a UK tax resident if its central management and control is exercised in the UK.

Limited Liability Partnership

Since April 2001, it has been possible to organize limited liability partnerships ("LLPs") in the UK. These vehicles are broadly akin to limited liability companies in the U.S. LLPs are extremely flexible vehicles which can be used by many types of business, such as professional partnerships, joint ventures, entrepreneurial businesses and investment structures. LLPs have no board of directors, but have members, as equity holders, but who have characteristics of both directors and shareholders. Unlike the UK limited company, there is no prescribed means by which a limited liability partnership must be managed. Management architecture is generally spelled out by agreement among members.

Limited liability partnerships are legal entities in their own right and, in general, it is possible to structure LLPs so that liabilities of the LLP to third parties cannot be extended to members. There are no maintenance of capital requirements for LLPs.

An LLP is treated in the UK as generally being tax transparent. The effect of this is that partners are taxed separately on their appropriate proportion of the profits of the LLP business and also are entitled to an appropriate share of losses and capital allowances. This allows for great flexibility when structuring the economics of members' interests. It must also be remembered that LLPs are controlled by the FSA to the same extent as companies, as outlined above.

UK Branch

Businesses organized in the United States may also consider, as an alternative to setting up a new UK subsidiary, estab-

lishing in the UK a branch or place of business. A branch is not a separate legal entity (and neither is a place of business). A U.S. company can only register a branch if it has been incorporated with limited liability in the U.S. The test as to whether a branch has been established is whether part of an overseas company is organized to conduct business through local representatives rather than referring it abroad, coupled with the appearance of permanency. If a branch is established, various details must be registered within one month of establishing the 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, which has far fewer filing requirements.

Overseas companies trading in the UK through a permanent establishment are liable to UK corporation tax on profits attributable to the permanent establishment.

Capital gains of U.S. 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.

The general application of UK taxation may, of course, be affected by the terms of tax treaties, which may limit the circumstances in which tax is chargeable and also limit the profits on which tax is payable. For instance, in the case of the tax treaty between the U.S. and the UK, 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.

Acquisition Or Merger

Another option a U.S. business may pursue to operate in the UK is the acquisition of an existing operating business. Unlike in the U.S., there is no concept of merger in English law (although the term "mergers and acquisitions" is used in the UK). An acquisition will generally require a greater initial investment than setting up a new company, but the U.S. company may gain immediate local presence, expertise and name recognition from the target of the acquisition. As in the U.S., steps include:

- entering into heads of terms (or a memorandum of understanding), including terms as to confidentiality and exclusivity;
- legal and financial due diligence by which the company being acquired is appraised;
- valuation, agreeing on 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);

- the preparation of contractual documentation (which the buyer's lawyers usually draft), including the purchase agreement, tax indemnity and related agreements; and
- negotiation and implementation.

Contractual Arrangement

Another alternative for a U.S. business looking to enter the UK market is a contractual arrangement with an existing UK business. Such an arrangement typically involves a much lower initial investment and may be sufficient when the activity to be conducted in the UK is more limited in nature. Where there is no permanent establishment in the UK, there will not usually be UK corporation tax to pay. A typical initiative would be an investment in a joint venture, usually organized as a limited liability company. A shareholder's agreement will typically regulate matters such as:

- the terms of the initial investment, including 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;
- distributions; and
- exit terms, such as pre-emption rights, drag-along and tag-along rights, and rights on an IPO.

Other Considerations

EC and UK competition laws apply to all business activity in the UK. 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.

There are also important differences in labor laws between the UK and the U.S. In the UK, employees enjoy considerable protection of their rights, such as statutory entitlements to vacations, significant protections against dismissal, limits on the number of hours an employee can work (usually no more than 48 hours a week) and parental benefits.

Summary

Each of the methods outlined above has its benefits, whether it be favorable tax treatment, minimal set up costs or limited liability. When the right approach is chosen and correctly applied, the setting up of a business in the UK can be profitable.