Legal Status of a business

Different Types of Business

Sole Traders

*A sole trader is the simplest form of business organisation. There are no legal requirements - you simply set up and get on with trading. Any income or profit that you earn is yours and yours alone and you pay income tax on that income. There are few legal constraints and you have what is called **unlimited liability**. This means that any debts are your debts and so if you stop trading with large debts, you will be personally responsible for these debts. Creditors will have a claim on your house, yacht or any other personal assets you may have.*

- ***Advantages***
  - *Cheap and easy to start*
  - *All the profit is yours*
  - *You are your own boss*
  - *You do all the work*
- ***Disadvantages***
  - *You have NO limited liability*
  - *All the risk is yours*
  - *What about sickness and holidays?*
  - *Do you have all the skills?*

Tax implications

There are also important tax implications of operating a sole proprietorship. Net business income from a sole proprietorship must be included as part of the sole proprietor's personal income. However, if the business suffered a loss, the owner can deduct the loss from other income he or she has received for that year. This will lower the overall taxable income of the owner and reduce the amount of personal income tax that must be paid. If the business made a profit, the profits are taxed at the owner's personal income tax rate. In general, it is better from a tax standpoint to be a sole proprietor if you expect the business to lose money in its early years and you have income from another source, such as employment income.

Business taxation can be very complicated, and it is usually a good idea to contact a tax lawyer or a chartered accountant to determine the tax implications of your particular situation.

Normally, sole proprietorships are best for businesses earning a small profit which do not have significant liability concerns.

Partnership

This is, in essence, like a sole trader but with the ownership shared between partners. However, a partnership should have a partnership agreement (a legal document) drawn up to show the rights and responsibilities of all the partners. There may also be 'sleeping partners' who own a share of the business but are not involved in the day-to-day running of the business. A partnership also has unlimited liability. Partnerships are common in the professions such as accountancy and law.

Since April 2001 there has been a new form of partnership called a limited liability partnership (llp). This is like a cross between a partnership and a limited company as it has limited liability (like a limited company), but has to be owned by at least two members - being a partnership!

- ***Advantages***
  - *Partnership allows two or more people to work together*
  - *Bring different skills and resources to the business*
  - *Partnership is fairly easy to establish*
  - *If the partnership suffers a loss but the partners have other employment income, the loss can be used to reduce their taxable income, thereby lowering the income tax payable by the partner*

- ***Disadvantages***
  - *The partnership is not considered to be separate from its owners*

- *the partners are personally responsible for liabilities of the partnership*
- *If the business fails, the partners will be personally responsible to pay all of the debts and obligations of the partnership*
- *because each partner is an agent for the business and for the other partners, each partner is personally responsible for the actions of the other partners*
- *If one of the partners makes a bad business decision, or acts negligently which results in the partnership owing a debt, all of the other partners are personally responsible to pay it back.*
- *Because a partnership is based on the individual partners, and it is not a separate legal entity, if one of the partners dies, the partnership ends. This means that the remaining partners have to re-establish the partnership.*
- *Because a partnership is not a separate legal entity, it is difficult to buy or sell a partnership interest. Buying or selling a partnership interest will involve rewriting the partnership agreement and determining exactly how the partnership will change.*
- *Although the resolution of disagreements amongst partners is generally covered under a partnership agreement or case law, it usually is very difficult. There is no Act that exists which sets out rules for settling partnership disputes. If the disagreements are not resolved by the partners themselves, they will usually have to turn to outside help which can be time consuming and costly.*

Tax implications

There are tax implications to owning a partnership interest. First, the business income of a partnership is divided between the partners and included on each partners' personal income tax form; the partnership does not file a separate tax form. Second, if the business has suffered a loss, the partners can deduct the loss from any other employment income they receive. This will lower the overall income of an individual partner and reduce the amount of income tax he or she must pay. Third, if the business has made a profit, the profits are taxed at each partners' personal income tax rate. Fourth, because the partnership is not a separate legal entity, the partners cannot take advantage of income splitting or tax deferral opportunities available with corporations.

For more information or advice about partnerships or if you are uncertain about what form of business is best for you, you should contact a lawyer.

<u>Private limited company</u>

A private limited company is one where the liability is limited. Unlike a sole trader where the liability is unlimited, with a limited company the liability is limited to the value of the shares issued. This means that any debts are debts of the company and not of the owners. To form a limited company it must be registered at Companies House and the firm must have various legal documents including a Memorandum and Articles of Association. There need only be one director and they have to prepare annual accounts and submit them to Companies House. Private limited companies can range significantly in size.

- ***Advantages***
    - *You have limited liability*
    - *Easier to raise larger sums of capital*
    - *More flexible than PLCs*
    - *Opportunities for bringing in more skills*
- ***Disadvantages***
    - *You can only sell shares privately*
    - *Not very flexible if expansion becomes possible*
    - *More legal formalities than sole traders*

Public limited company

Like a private limited company, a plc has shares, but the key difference is that these shares can be bought by anyone freely on a stock exchange. Ownership is therefore open to anyone who wants to buy shares. PLCs have legal requirements in that they have to produce annual reports and accounts and file them with Companies House. There are various other requirements including:

- *You must have at least two directors.*
- *You have a fully qualified Company Secretary.*

- ***Advantages***
  - *You have limited liability*
  - *Easier access to finance*
  - *More funds available for investment*
  - *Public awareness gives status*
- ***Disadvantages***
  - *You have to publish results*
  - *Others, e.g. auditors have to look at your books*
  - *Greater need to conform to legal procedures*
  - *Owners might lose control*

Charitable Organisations

Voluntary, Charitable and similar organisations are usually non-statutory (not part of central government or a local authority) and non-profit making. There are exceptions to this in that some organisations are co-ordinated by workers from statutory services and some either pay staff to assist their work or charge a fee for the service. There are other voluntary organisations comprised of groups of similarly experienced people who wish to share their experiences for mutual support.

- ***Advantages***
  - *Funding - Opportunity to attract other sources of funding available only to charitable organisations.*
  - *Status - Recognised and highly regarded status and security in terms of its position.*
  - *Mandatory National Non Domestic Rate (NNDR) - 80% mandatory relief from business rates.*
  - *Discretionary NNDR - Possibility of additional relief for the remaining 20% of business rates (at the discretion of the local authority).*
  - *Corporation Tax - Exemption from corporation tax on income (provided the income is used only for charitable purposes).*
  - *Other Fiscal Advantages - Exemption/relief from taxes, including capital gains, income tax and inheritance tax.*
  - *Donations - Tax relief on donations to charities enhancing the value to the charity and encouraging donors to give more generously. (This tax relief relates to voluntary donations not mandatory contributions to the BID scheme).*
  - *Sponsorship - Reliefs for corporate sponsorship, again encouraging support through mutual tax advantage.*
  - *Stamp Duty - Stamp duty not payable on gifts to, and purchases of land and shares by, charities.*
  - *Exemption from, and reduced liability for, certain municipal, provincial and federal taxes.*
  - *The ability to issue income tax credit receipts for donations.*
  - *Charitable status generally provides an organisation with a positive image from the public's perspective.*

- ***Disadvantages***
  - *Regulation - A registered charity will need to comply with the regulatory requirements of the Charity Commission. It might be said that such regulation is a positive advantage and seen as an important means of safeguarding the assets of the organisation.*
  - *Restriction on Activities – a charity can only undertake charitable activities as defined in charity law. These are limited and could restrict the intended activities of the BID partnership.*

- *Application - The assets of a charity can only be used for charitable purposes of that charity or transferred to another charitable body for similar purposes. Reversibility is, therefore, difficult.*
- *Trading - Any non-charitable, commercial or trading activities (unless deemed ancillary) will need to be undertaken by a subsidiary trading company.*

Franchises

A franchise is a contract or agreement where a franchisor gives a franchisee the right to start a business under a business system that already exists. Under the franchise agreement, the franchise business usually uses the name or trademark of an existing company and conducts the same type of business as the existing company. The franchisee has a right to use the name or trademark of the existing company and the franchisor gets to have some control over the franchisee's business. The franchisor also has a continuing right to receive payments from the franchisee.

- ***Advantages***
  - *You are able to operate your own business while still having the security of working with a large company*
  - *You may not have to be an expert at running your own business because you will usually receive support from the franchisor.*
  - *You enjoy the benefit of using the franchisor's reputation. As a result, there is less business risk for you if the franchise has developed a successful product*
  - *It may be easier to borrow money to buy a franchise than to start an independent business.*

- ***Disadvantages***
  - *Depending on the franchisor and the franchise agreement, the franchisor may maintain a substantial amount of control over new franchises. In typical franchise situations, the franchisor will set the opening and closing times of the franchise, determine what is to be sold and how it is to be sold, and will put restrictions on the ability of the franchisee to sell his or her franchise. You should discuss this before you enter into a franchise agreement.*
  - *Franchisees usually have to pay an upfront fee simply to begin using the business name. To continue using the name, the franchisee will usually have to pay a set fee either every month or every year. These fees can be substantial. In exchange, the franchisee gets to use the franchise name and sell the franchise product. People will know your business name and you will not have to spend time developing a marketing plan or customer recognition of your business.*
  - *There are many complicated legal issues involved with buying and operating franchises. You should consult a lawyer and an accountant if you plan to enter a franchise agreement.*

Laws of business

Memoranda and articles of association

The memorandum of association defines the following key points:

The company name
The address of the registered office
A statement of limited liability
A statement of the companies authorised share capital and share price.
What the company will do (the objects)

Statutory Books

Statutory Books are the official records kept by the company relating to all legal and statutory matters

Statutory declaration

Partnership agreements

The Companies Act 1985 and 1989

The Partnership Act 1980

The Business Names Act 1985

Contract, Consumer and Employment Law

Standard Forms Of Contract

Forming An Agreement

Capacity To Contact And Intention To Create Legal Relations

Consideration

Illegality

Duress And Undue Influence

Exclusion Clauses

Express And Implied Terms

Termination Of A Contract

Arbitration In Circumstances Of Dispute