

## **1. INTRODUCTION**

The aim of this article is to deliver an outline of the various options available to a business seeking entry into the UK market and to identify the relevant regulatory controls.

Emphasis will be placed on the private company limited by shares, its requirements as to incorporation formalities, management structure and applicable tax provisions.

The information set out in this note is not exhaustive and legal and other advice should be sought before acting on it.

## **2. METHODS OF MARKET ENTRY IN ENGLAND & WALES**

### **2.1 DISTRIBUTION AND AGENCY**

A business planning to enter the UK market may choose to do so by appointing either an agent or a distributor. The two options have different legal consequences. An agent acts as an intermediary between the supplier and the customer. However, only the supplier and the ultimate purchaser are parties to the resulting contract. The distributor on the other hand will buy the goods from the supplier and re-sell them at his own financial risk and on his own account. The relationship between principal and agent is governed, amongst other things, by the Commercial Agents (Council Directive) Regulation 1993. The regulations provide, for example, that upon termination of the agency agreement the agent will be entitled to compensation or an indemnity, irrespective of whether the principal is in breach of contractual obligations.

The parties to a distributorship agreement are – subject to the principles of contract law – free to regulate their relationship as they wish. However, care must be taken so not to fall foul of restrictions imposed by English and European competition law. A supplier wishing to establish his products in a new territory will want to offer the distributor a long term contract but may reserve for himself the right to terminate the agreement.

Furthermore, the distributor may for his part include a provision giving him the right to extend the term fixed in the agreement.

### **2.2 BRANCH/PLACE OF BUSINESS**

For overseas companies, establishing a branch office or a place of business in England & Wales is often seen as a natural progression from trading through agents or distributors. English law requires that physical extensions of overseas companies by way of branches and places of business are registered with the Registrar of Companies.

Registration of a branch will be appropriate where business is conducted from the UK and there is a presence of representatives of the overseas company in the UK.

In contrast, a place of business registration would be appropriate if no authorised personnel operate from local premises or if the company's UK activities are ancillary to its main business overseas, for example, a warehouse.

### 2.3 PARTNERSHIPS

English general partnerships are mainly governed by the Partnership Act 1890 and by the common law. Partnerships are not separate legal entities and the partners will be personally liable for the partnership's debts. Additionally, a partner can be held liable for another partner's wrongdoing, in which case they may claim an indemnity from the partner who is at fault.

Many businesses (including professionals such as accountants and architects) nowadays may prefer a limited liability partnership (LLP) to the general partnership, the main advantage being its partners' limited liability. Governed by the Limited Liability Partnership Act 2000, an LLP is an entity with a separate legal existence from its members. It is taxed as a partnership and at least internally benefits from the same organisational flexibility. However, its filing and accounting requirements are more or less the same as those of a company. It must also be registered with the Registrar of Companies.

The limited partnership, governed by the Limited Partnerships Act 1907, is relatively rare these days (save in the context of investments funds and property development). Limited Partnerships are currently the subject of proposed reform, the Government having published a draft reform order in June 2009.

### 2.4 ENGLISH LIMITED LIABILITY COMPANIES PUBLIC AND PRIVATE

Alternatively, foreign businesses may choose between two types of limited liability companies: public and private limited companies. Both types of companies are recognised as separate legal entities that can for instance enter into agreements as a contracting party.

A public company limited by shares must have an authorised share capital of at least £50,000 and can be identified by its name which must contain the word 'plc'. At least 25% of the nominal value of a share must be paid up upon issue or allotment. Additional capital may be raised by way of floating shares on a stock exchange.

A private company limited by shares on the other hand is not allowed to offer its shares to the general public, does not have a minimum share capital and can be recognised by the word 'Limited' or 'Ltd' in its name.

Since 8 October 2004 it is also possible to form a European company (Societas Europaea) which is governed partly by legislation passed by the EC and partly by English law.

## 3. FORMATION OF A LIMITED LIABILITY COMPANY

### 3.1 INCORPORATION

Establishing either a private or a public company requires a certificate of incorporation to be issued by the Registrar of Companies. Beforehand the company must have filed the necessary constitutional documents, comprising the "Memorandum of Association", the "Articles of Association" and a statement of the first directors and company secretary. In addition, a public company requires a certificate verifying that the relevant share capital has been raised. A private company may re-register as a public company and vice versa.

The Companies Act 2006 has brought in a number of changes to company law. Notably, the objects clause in the Memorandum of Association will be abolished and instead a company's objects will be unrestricted unless the Articles of Association specifically indicate otherwise.

### **3.2 PAYMENT FOR SHARES**

A person may become a member of the company either by being a subscriber of shares when the company is first incorporated or by being allotted/issued shares at a later stage. Once a person has been registered as a shareholder s/he will be liable for the debts of the company liable up to the amount of the par or nominal value of the shares held by him/her.

If a company accepts a non-cash consideration for its shares, a private company may place an enhanced value on such assets/services provided that the directors act in good faith. In relation to a public company however, the consideration must be valued by an independent valuer, qualified to act as the company's auditor. If the consideration takes the form of property it must pass to the company within five years of the allotment of shares.

### **3.3 PRIOR ACTIVITIES: PROMOTERS AND PRE-INCORPORATION CONTRACTS**

Contracts entered into by so-called promoters purporting to act on behalf of the company before its incorporation are known as "pre-incorporation contracts". As the company does not yet have its own legal identity, liability is shifted to the promoter.

In compliance with an EC directive, English law states that such a contract is deemed to be made with the person purporting to act for the company and this person shall be personally liable on the contract. English common law further provides that a company may have rights and obligations under such a contract where there has been 'novation'; the substitution of a new contract for the pre-incorporation contract once the company has been formed.

## **4. MANAGEMENT OF A LIMITED LIABILITY COMPANY**

Both public and private companies are represented by a Board of Directors. A private company is only required to have one director whereas a public company must have at least two. The Companies Act 2006 now requires at least one director to be a 'natural person'. The directors control the company's day-to-day business and owe a duty to the company.

### **4.1 POWERS AND DUTIES**

The directors of a company have such powers as are given to them by the Articles of Association of the Company. It is an established practice for a widely drawn delegation of general powers to the directors to be included in the Articles. They are collective powers which must be exercised at board meetings.

The general rules of agency law also apply to directors of companies so that individual directors as a matter of practice have the authority to bind the Company (subject for example of any limitation of authority of which the 3rd party was aware).

A director has both statutory and common law duties. Statutory duties comprise those recently codified and set out in Chapter 2 of Part 10 of the Companies Act 2006. The duties

include duties to act within powers, promote the success of the Company, exercise independent judgement, exercise reasonable care and skill, avoid conflicts of interest, declare any interests in business of the Company and not to accept benefits from third parties.

## **4.2 APPOINTMENT**

The first directors of the company are identified in the document sent to the Registrar of Companies and are then automatically appointed when the company is incorporated.

Any subsequent appointments or dismissals are generally appointed by the shareholders (as regulated by the Articles of the Company). Directors retire by rotation at the annual general meeting but may be immediately reappointed (and in practice often are).

It is common for directors to enter into a service contract with the company setting out the terms of their appointment (including salary and termination provisions).

## **5. OFFICERS' LIABILITY OF A LIMITED LIABILITY COMPANY**

### **5.1 LIABILITY**

A director is obliged to adhere to his statutory and common law duties. In the event of a breach of these duties, the company may sue him for breach of duty. In cases where a director exceeds his powers, the company may apply to the court for an injunction to restrain the directors from performing the illegal act. The company may also have grounds for claiming compensation from the directors for any loss caused by their action.

Under the Companies Act 2006, a company may not generally exempt a director from, or indemnify him against, liability regarding any negligence, default or breach of duty committed by him in relation to the company. This is subject to a relaxation whereby companies may provide a qualifying third party indemnity provision (QTPIP). The Companies Act 2006 introduced several changes to directors' liability including a right for shareholders to request a copy of a QTIPI as well as the requirement for all companies to retain all QTPIPs for at least one year after they have expired. In addition, the Act also codified the common law on ratification of a director's breach of duty by introducing into statutory law the shareholders' ability to ratify by ordinary resolution a director's conduct.

Directors may become personally liable for the debts of the company, for example in an insolvency situation.

## **6. TAXATION OF PROFITS**

### **6.1 CORPORATION TAX**

In the UK, a company will pay corporation tax on the profits of its business. The profits encompass all sources of income and gains. A company will pay corporation tax by reference to each accounting period and must pay it within nine months from the end of the relevant accounting period.

There are two key corporation tax rates: the small companies' rate which applies to companies with chargeable profits of less than £300,000 and the main rate which applies to companies with chargeable profits of £1,500,00 and over. These bands are reduced proportionally if the company in question belongs to a group of companies.

For the financial year 2011, the small companies' rate is at 21% and the main rate is 28%. If a company's profits falls between the two rate bands a marginal relief applies which taxes these profits at an effective rate of tax of 29.75%.

The depreciation in value of the assets acquired by the company for use in the business is not an allowable deduction from the business' profits for corporation tax purposes. However, it is possible to obtain relief for certain plant and machinery (and certain buildings) in the form of capital allowances.

## 6.2 DOUBLE TAXATION

Companies which are UK residents have to pay corporation tax on the whole of their worldwide profits and gains. Non-UK resident companies which have UK source profits must pay corporation tax on this source if the company trades through a branch or permanent establishment in the UK and if the UK source profits are derived through that branch or permanent establishment.

If the company is resident in a country which has a double taxation treaty the provisions of the specific double taxation treaty .

## 6.3 EUROPEAN COMPANY

Following the implementation of the European Company Statute into English law, if controlled in the UK a European company will be subject to UK tax.

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