Choosing the right Trading Vehicle

There are a number of different trading vehicles or business formats that can be used for carrying on business in the UK including:

Sole traders

A sole trader runs a business alone, makes all decisions affecting the business and owns all the assets of the business personally. Small businesses often operate as sole traders because of the lack of legal formality and the low administration costs involved in setting up and running the business.

General partnerships

A general partnership is defined as the relationship which exists between persons carrying on a business in common with a view to profit. General partnerships are governed by the Partnership Act 1890 (PA 1890). However, it is usual practice for the partners to enter into an agreement which governs their relationship as partners and which supplements or displaces particular provisions that would otherwise apply under the PA 1890. Such an agreement can be express or implied, written or unwritten.

Companies

A company is a trading vehicle existing in its own right; that is, it is a separate legal entity from the people who own and manage it. The most common form of company used in practice is a company limited by shares. A company limited by shares can either be a private company or a public company. In addition there are companies limited by guarantee which are normally incorporated for non-profit making functions and have many of the same characteristics as a private company limited by shares and unlimited companies which do not have any limit on the liability of their members and share some of the characteristics of a private company limited by shares but with a number of key differences.

Limited liability partnerships (LLPs)

A limited liability partnership (LLP) is a hybrid form of business entity that combines many of the benefits of a limited company with the organisational flexibility of a general partnership.

Whereas the choice of which trading vehicle to use will very often be determined in conjunction with their accountants and tax advisors, it is important for business owners to understand the key features of each before making a decision.

Key features

Sole trader

The key features of a business operating as a sole trader include:

- **No separate legal personality.** There is no legal separation between the business and the affairs of a sole trader. A business operating as a sole trader cannot own assets in its own right, or grant security over them.

- **Unlimited liability of participators.** A sole trader is personally liable, without limit, for all of the debts and other liabilities of the business.

- **Number of participators.** There can only be one owner/manager in a business that is operated as a sole trader.

- **No separation between management and ownership interest.** The sole trader owns all the assets of the business personally and has full control over running the business. The sole trader makes all the decisions affecting the business.

- **Minimal formation formalities and filing requirements.** There are no formation formalities or filing requirements for setting up a sole trader business.

- **Constitutional documents.** There is no need for a business operating as a sole trader to adopt constitutional documents.

- **Ongoing administration and filing requirements.** A sole trader business is not required to file accounts or other documents with Companies House.

General Partnership

The key features of a business operating as a general partnership include:

- **No legal personality.** A general partnership does not have a legal personality separate from its partners. A general partnership cannot own assets in its own right, nor can it grant security over them.
- **Unlimited liability of participators.** Partners are jointly liable for the debts and obligations of the partnership business. Partners are also jointly and severally liable for the wrongful acts or omissions of their fellow partners in the ordinary course of the partnership business, or with the authority of the other partners.
- **Number of participators.** There must to be at least two participators in the business for a partnership to exist. There is no statutory upper limit on the number of partners in a general partnership. A partner in a partnership can be a company as well as an individual.

- **No separation between management and ownership.** The default position is that every partner has a right to participate in the management of a general partnership and participate equally in the partnership assets and profits.
- **Minimal formation formalities and filing requirements.** No legal formalities are required to set up a partnership and it is not necessary to register a general partnership with Companies House. Partners will, however, usually regulate their affairs by entering into a formal partnership agreement.
- **Constitutional documents.** There is no need for a business operating as a general partnership to adopt constitutional documents. The partners are not required to enter into a formal agreement to regulate the conduct of the business and their relationship as partners, although in practice most partnerships will do so.
- **Ongoing administration and filing requirements.** A general partnership is not required to file accounts or other documents with Companies House.

LLP

The key features of an LLP include:

- **Separate legal personality.** An LLP is a body corporate with a legal personality separate from that of its owners (known as members). An LLP can hold its own assets and grant charges over them. It can enter into contracts in its own right, and can sue and be sued in relation to those contracts.
- **Limited liability of participators.** An LLP is liable for its own debts. The business liabilities and debts are the responsibility of the LLP, and not its individual members. The members of the LLP have financial exposure only to the extent of their capital investment (if any) in the LLP.
- **Number of participators.** There is no statutory upper limit on the number of members in an LLP, but there should be a minimum of two members, at least two of which must be designated members. However, the LLP will not cease to exist if the number of members falls below two. Companies can be members in an LLP.
- **No separation between management and ownership.** The default position is that there is no separation between the ownership and management of an LLP, as every member has a right to participate in its management.
- **Capital.** An LLP has no share capital. There are no capital maintenance requirements and, unless otherwise agreed between the members, there is no obligation for members to contribute capital to the LLP.
- **Formation and filing requirements.** A specified statutory procedure must be followed in order to incorporate an LLP, which includes registering certain documents with Companies House. A fee is payable to Companies House on incorporation of an LLP.
- **Constitutional documents.** There is no need for an LLP to adopt constitutional documents. The members are not required to enter into a formal agreement to regulate the conduct of the business of the LLP and their relationship as members, although in practice most LLPs will do so.
- **Ongoing administration and filing requirements.** LLPs are subject to ongoing filing and disclosure obligations which are broadly the same as those applicable to companies. Such obligations include the requirement to file an annual confirmation statement and annual accounts with Companies House, and to notify any changes in its registered particulars (including any changes to its membership). A fee is payable in relation to some of these ongoing filing obligations.

Company limited by shares

A company limited by shares can either be a private company or a public company. The key features of all companies limited by shares (whether private or public) include:

- **Separate legal personality.** A company limited by shares is a body corporate and has a separate legal personality from that of its owners (known as shareholders). A company holds its own assets and can grant charges over them. A company enters into contracts in its own right, and can sue and be sued on those contracts.
- **Limited liability of participators.** A company limited by shares is responsible for its own debts and liabilities. The liability of each shareholder for the company's debt and other liabilities is generally limited to the amount which remains unpaid on that shareholder's shares.
- **Number of participators.** There is no statutory upper limit on the number of shareholders in a limited company. A company limited by shares can be formed with a single member.
- **Separation of management and ownership.** There is separation between the management and ownership of a limited company. The owners of the company are its shareholders. Responsibility for the management of the company generally falls to its directors. Although in many instances the directors of a company will also be shareholders, this is not a legal requirement.
- **Share capital.** A company limited by shares must have an issued share capital comprising at least one share. Each issued share must have a fixed nominal

value. There are strict statutory controls over how a company can alter its share capital. There are also strict statutory controls on a company's ability to make returns of value to its shareholders.

- **Formation and filing requirements.** A specified statutory procedure must be followed in order to incorporate a company limited by shares. This includes registering specified documents with Companies House. A fee is payable to Companies House on incorporation of a company limited by shares.
- **Constitutional documents.** All companies must have articles of association, which set out the basic management and administrative structure of the company. The articles of association are a public document. A copy of a company's articles must be filed with Companies House on incorporation (unless the company has adopted model articles), and the company must notify Companies House of any changes that are made to its articles during the life cycle of the company.
- **Ongoing administration and filing requirements.** Companies are subject to extensive ongoing filing and disclosure obligations. Some of these obligations occur on an annual basis (such as the requirement to file a confirmation statement and annual accounts with Companies House), while others are event driven obligations (such as the obligation to notify any changes to its share capital, directors or other registered particulars). A fee is payable in relation to some of the ongoing filing requirements.

Private company limited by shares

A private company limited by shares differs in a number of respects from a public company. The key differences include:

- **No minimum issued share capital.** The nominal value of a private limited company does not have to exceed a specified amount. So, for example, it is possible (and common in practice) to incorporate a private company with a share capital comprising a single share with a low nominal value (such as £1.00 or less).
- **No restriction on amount paid up on shares on issue.** Unless its articles of association provide otherwise, a private company can issue shares on terms that the subscription price for the shares will be partly paid or nil paid on issue.
- **Shares cannot be offered to the public.** A private company is prohibited from offering its shares to the public.
- **Officers.** A private limited company must have at least one director. A private company is not required to have a company secretary, although it may choose to do so.
- **Company name.** Subject to certain statutory exceptions, the company's name must include the word "limited" or "ltd" (or the Welsh equivalents).
- **Shareholder meetings and decisions.** Provided it is not a traded company, a private company is not required to hold annual general meetings unless its articles of association provide otherwise. Decisions of the shareholders in a private company can be taken by way of a written resolution.
- **Capital reductions, redemptions and share buybacks.** Private companies have more flexibility in terms of procedure and source of funds for carrying out a reduction of capital, redemption of shares or share buyback. A private company can provide financial assistance for the purchase of its own shares.

Public limited company

The key characteristics of a public limited company (PLC) which differ from its private counterparts include:

- **Minimum issued share capital.** The nominal value of a PLC's issued share capital must not be less than £50,000.
- **Amount paid up on shares.** Not less than a quarter of the nominal value and the whole of any premium payable on shares issued by a PLC must be paid up on allotment. There is a limited exception to this rule for shares issued pursuant to an employee’s share scheme.
- **Type of consideration for shares.** There are a number of statutory controls and restrictions on a PLC's ability to issue shares for non-cash consideration.
- **Shares can be offered to the public.** Public companies can offer their shares for sale to the public and can therefore be listed on a recognised stock exchange. However, not all PLCs are listed companies. If a PLC is listed, it will be subject to an additional layer of rules and disclosure requirements relating to the relevant investment exchange.
- **Officers.** A PLC must have at least two directors and is also required to have a company secretary. The company secretary must meet the qualification requirements set out in the Companies Act 2006.
- **Company name.** The name of a public company must include the words "public limited company" or "plc" (or the Welsh equivalents).
- **Shareholder meetings and decisions.** A PLC must hold an annual general meeting every year. A PLC cannot take shareholder decisions using the written resolution procedure set out in the Companies Act 2006.
- **Capital reductions, redemptions and share buybacks.** There are tighter capital maintenance

restrictions applicable to PLCs. For instance, a PLC can only reduce its share capital using a court-based procedure, PLCs cannot fund a redemption or purchase of its own shares out of capital and PLCs are prohibited from giving financial assistance for the purchase of their own shares

Company limited by guarantee

A company limited by guarantee has many of the same characteristics as a private company limited by shares, subject to the following key differences:

- **No share capital.** Since December 1980, companies limited by guarantee have been unable to issue share capital.
- **No liability for members to contribute while company is a going concern.** The members of a company limited by guarantee undertake to contribute a predetermined nominal sum to the liabilities of the company, which becomes due in the event of the company being wound up. The amount that members undertake to contribute is not an asset of the company but a contingent liability of members to contribute in the event of a winding up. Members are liable to contribute while they are members of the company, and within one year of ceasing to be a member.
- **Company name.** The Registrar of Companies may agree to dispense with the word "limited" from the name of a company limited by guarantee if certain requirements are met.

Unlimited companies

An unlimited company shares many of the characteristics of a private company limited by shares, subject to the following key differences:

- **Share capital optional.** An unlimited company can choose to be registered with or without a share capital.
- **Unlimited liability of members.** There is no limit on the liability of the members of an unlimited company. However, the members are not directly liable to the creditors of the company. If an unlimited company fails to discharge its debts, its creditors can petition for the company to be wound up, following which the liquidators may require the members to contribute to the company's assets to the extent necessary for the payment of its debts, liabilities and the expenses of winding up. Past members may also be liable to contribute to the assets of an unlimited company in these circumstances, subject to a number of limitations.
- **Must be a private company.** Unlimited companies must be private companies.
- **Company name.** An unlimited company is prohibited from using the word "limited" in its name.
- **No obligation to file accounts.** Unlimited companies are exempt from the requirement to deliver annual accounts and reports to the Registrar of Companies, unless they are a subsidiary or parent of a limited company.
- **Return of allotments.** If an unlimited company has a share capital, it is not required to file a return on the allotment of shares unless the shares allotted are a new class of shares.
- **Relaxation of maintenance of capital rules.** Unlimited companies enjoy much greater flexibility than limited companies in relation to reductions of capital and the redemption or purchase of their own shares.

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