United Kingdom

Legal overview

Summary

The UK is relatively lightly regulated when it comes to corporate formalities. Many documents can be executed in electronic format and company registrations are cheap, simple and many filings can be completed over the internet.

Registered companies and partnerships

The two most common ways for a non-UK company to establish a UK presence are through either a UK resident subsidiary company or a UK permanent establishment (such as a branch).

A company that is incorporated in the UK is automatically UK resident unless an applicable double tax treaty provides otherwise.

A non-UK incorporate company is UK tax resident if it has its "central management control" in the UK (subject to any applicable double tax treaty). Although in determining the status a number of factors must be considered and no single factor is necessarily conclusive.

Some businesses trade as partnerships. These are not as popular as they once were as the partners have unlimited liability. Partnerships, however, have the advantage that their accounts are private and are not open to public inspection unlike a company or an LLP.

In the UK it is possible to trade through a limited liability partnership (LLP). This has limited liability, like a limited company, but is taxed in a different way. A company in the UK is taxed on its profits. An LLP is not taxed on its profits but its members are taxed individually on the profits of the LLP as if they are partners. LLPs are often used for partnership arrangements and joint venture arrangements as well as for professional services businesses.

Classification of Registered Companies

In the UK there are four principal types of company:

- Company limited by shares – these may be private or public companies. Private companies limited by shares constitute the vast majority of all companies registered in the UK;

- Companies with unlimited liability which are rare because the shareholders have unlimited liability to the extent the company is unable to pay its debts;

- Companies limited by a guarantee. These companies are normally incorporated for non-profit making functions, with no share capital and members rather than shareholders. The members undertake to contribute a pre-determined nominal sum to the liability of the company which becomes due in the event of the company being wound up; and

- Community interest companies. These companies are designed for social enterprises and for using their profits and assets for the public good.

Memorandum and articles of association

The main constitutional document for a company is its articles of association. All registered companies must have articles of association and a company must register its articles of association at a public registry unless it adopts the statutory template model articles.

In addition to the new articles of association, a company has a memorandum of association. In the UK, this is a very simple document and provides basic information, for example, about the initial shareholders.

Share Capital

Share capital only applies to a company limited by shares.

The liability of the shareholders is limited to their contribution to the issued shares.

Public Offer of Shares

In order to be a public company, the company must have a share capital of at least £50,000. Additional restrictions apply to public companies. Public companies are also able to apply to list their shares for public dealing, for example on the London Stock Exchange or on the alternative investment market (AIM), but a company must comply with a whole range of detailed listing regulations if it wishes to go for a public listing.

This is often referred to as an IPO (Initial Public Offering). This can only be made by a public company, by listing shares on a recognised securities exchange, such as the London Stock Market. This is a detailed and costly process which also involves on-going listing/regulatory fees and charges. The listing process involves the circulation of a prospectus.

General Meetings

The rules applicable to shareholder meetings of companies vary depending on whether the company in question is a private limited company or a public limited company and also whether the company is a single shareholder company, a trading company, a listed company and a quoted company. The trend in the UK in recent years has been to relax the requirements for general meetings of private limited companies, particularly where they have a single member. For example, a public company must hold an annual general meeting each year, whereas many private limited companies do not require to hold annual general meetings at all.

Some of the decisions of a company, particularly major constitutional issues, must be decided by the shareholder(s) of the company.

Directors

A private limited company requires at least one director. The director or directors usually have the general day to day management of the business and take all decisions except for those reserved to the shareholders. The directors owe fiduciary duties to the company which are codified in company legislation. This means they under obligations, as an example, to act in the best interests of the company and not just follow shareholders direction.

Directors do not have to be UK citizens. They can be based outside of the UK provided the articles of association of the company contain appropriate provisions.

Financing of a company

Companies are financed in a number of ways:

- Capital contribution from shareholders in the form of shares.
- Loan, debt and bank finance.
- Equity investment from private equity funds.
- Grants.

From the directors'/shareholders' point of view the advantage of limited liability in practice might be negated to the extent that any personal guarantees are required to be given to third party funders.

Commencement of business

There are various requirements that need to be filed before a company may commence business. A simple company formation will generally take about three days to register. A company will need to register with the tax authority and will need to open a bank account. For an overseas company it can take between 6 weeks to 12 weeks to be ready to trade.

Mergers and acquisitions

Private limited companies are normally sold via private negotiations. Where one entity acquires the shares of another it is referred to as a "share-sale". Sometimes it can be more preferable to purchase the business of another entity, leaving liabilities with the target corporate entity, referred to as an "asset-sale".

Takeovers of public limited companies in the UK are strictly governed under the relevant codes of practice. There are restrictions on offering shares in private companies for sale to the public and such negotiations are usually conducted with a small number of interested parties on a confidential basis.

Corporate insolvency

UK legislation protects creditors of companies.

If a company becomes insolvent the procedures that apply include a liquidation of the business, administration or some form of rescue package.

Where a company goes into administration or is wound up on grounds of insolvency, the directors' conduct is reviewed. If directors have acted contrary to insolvency laws they can face disqualification proceedings, or in a serious situation, they can face proceedings to recover monies from them personally.

Rescue mechanisms include what is known as a "company voluntary arrangement". This is when the company and its creditors come to an agreement which is implemented and supervised by a qualified insolvency practitioner and may involve the creditors being paid a proportion of the monies they are owed in full and final settlement.

Under an administration, the company is given a breathing space under which there is a moratorium to allow it to be rescued or re-organised, or its assets realised following which the company is wound-up.

Winding up of companies

Winding up or liquidation is the final resort, although it may be the simplest and most effective way of applying pressure to the company. This involves the appointment of a liquidator who must be a qualified insolvency practitioner who collects in and sells the company's assets and distributes the resulting cash. There are two types of liquidation, either a compulsory liquidation by order of the Court, or a voluntary liquidation by resolution of the company.

There are two forms of voluntary liquidation – either a members' voluntary liquidation where the directors are willing to give a declaration that the company will be able to pay all of its debts within 12 months, or a creditors' voluntary liquidation where the directors are not able to give that declaration.

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Tax overview

Company registration

As mentioned above, companies limited by shares or guarantee, Community Interest companies and Limited Liability Partnerships have to incorporate and be registered with Companies House.

Setting-up taxation

The company will need to consider registration for tax and VAT.

HM Revenue and Customs (HMRC) in the UK is moving towards electronic forms and notifications via the internet. It should be noted, however, that paper forms are still required and accepted in some instances.

H M Revenue & Customs

Organisations must give HMRC specific information about itself company within 3 months of starting up in business. This can be done online.

HMRC will use this information to work out when the company must pay Corporation Tax.

H M Revenue & Customs - VAT

Companies also need to consider if it is beneficial to be VAT registered from the outset. The pros and cons are discussed later. If registering for VAT, form VAT 1 needs completing, and if registered as a partnership, form VAT 2 needs to be completed giving details of all the partners.

All businesses with turnover above £100,000 now have to file VAT returns online via the internet, as do all new VAT registrations irrespective of turnover.

The UK Government is currently working towards “Making Tax Digital”. MTD was introduced for certain businesses for VAT quarterly reporting from April 2019. This means that qualifying businesses will need to keep their accounting records in a digital format that links to the HMRC computer system.

National current benefit taxation

Corporate income tax

A limited company must file annual tax returns (CT600 corporation tax returns) with HMRC.

Companies are charged corporation tax at the rate applicable during the financial year (1 April - 31 March). Where a company's accounts period spans two financial years the profits for the period are apportioned between the years.

The corporation tax rate is currently 19%. This rate will reduce to 17% from 1 April 2020.

A company is required to make an estimate of its own liability to corporation tax and pay that liability by the normal due date, nine months after the end of the accounting period, without an assessment being raised. The company is required to send its completed self-assessment tax return (form CT600), accounts and tax computation to HMRC by the filing date, which is 12 months after the end of its accounting period. Penalties will be charged if it is late. These accounts and returns need to be submitted online to HMRC in iXBRL format.

HMRC may generally have 12 months from the filing deadline (24 months after the accounting period) to open an enquiry into the company's corporation tax return, otherwise the self-assessed figures are considered final.

If additional tax is determined to be payable, interest (and possibly penalties) will be charged on the additional tax due.

Sole Traders / Partnerships

Sole traders and partnerships are charged income tax at the rate applicable during the fiscal years (6 April - 5 April). The rates are as follows:

	2019/20	**Rate**
Lower (Under personal allowance - for most - exceptions will apply)	0 - £12,500	0%
Basic (For most people – exceptions will apply)	£12,500 - £50,000	20%
Higher (For most people – exceptions will apply)	£50,000 - £150,000	40%
Additional	£150,000	45%

*A zero starting rate for savings income up to £5,000 was introduced from 6 April 2015. This rate does not apply if taxable

non-savings income exceeds that amount. From 2018/19 the first £2,000 of dividend income will be tax free.

In addition, the following amounts of interest income will be tax free:
• £1,000 a year interest tax free for basic rate taxpayers
• £500 a year interest tax free for higher rate taxpayers

Tax free interest will not be available to those with income in excess of £150,000 a year.

There may also be a liability to Class 2 and Class 4 National Insurance Contributions, depending on the level of profit in each fiscal year. Class 2 contributions are at a weekly rate of £2.95 (2018/19). Class 4 NI is payable by the self-employed on profits.

Class 4 contributions are levied at 9% on profits between £8,632 and £50,000 for 2019/20. There is a further 2% charge for 2019/20 on profits in excess of the upper limit.

Taxation of Dividends

An important factor to consider when deciding whether to trade via a limited company or as an unincorporated business is the total amount of tax payable, not just the rate of tax on the profits. The reduction in the rate of corporation tax from 19% to 17% makes a limited company appear very attractive.

The shareholder/director does, however, then need to pay tax personally on the profits that he extracts from the company, so there is effectively double taxation. A big cost here is national insurance, payable by both the employer and employee on amounts extracted as a salary or bonus. Many owner-managed companies have tended to extract profits by paying themselves a low salary, with the balance being paid out as a dividend to minimise NICs.

Individuals have a £2,000 dividend tax allowance.

Individuals will pay no income tax on dividend income received up to that amount.

Dividend receipts in excess of £2,000 will be taxed at:
• 7.5% for basic rate taxpayers (previously effectively 0%)
• 32.5% for higher rate taxpayers (previously effectively 25%)
• 38.1% for additional rate taxpayers (previously 30.56%)

VAT

VAT is a tax on consumer expenditure and is ultimately paid by the final customer.

Most business transactions involve the supply of goods or services and VAT is payable if they are made: a) in the United Kingdom b) by a taxable person c) in the course or furtherance of business and are not specifically exempted or zero-rated VAT is collected by HMRC and is normally payable quarterly.

Registration

There are two different types of registration - compulsory and voluntary:

A. Compulsory

A person who makes taxable supplies becomes liable to be registered if:

a) At the end of any month, the value of his taxable supplies in the period of one year then ending has exceeded the registration limit, which is £85,000.

b) At any time, there are reasonable grounds for believing that the value of his taxable supplies in the next 30 days will exceed the £85,000 limit.

c) If, where a business carried on by a taxable person is transferred as a going concern, the taxable supplies for the twelve months prior to the transfer exceed £85,000.

In the most common situation, i.e. (a) above, the person must notify HMRC of the liability within 30 days of the end of the month in which the value of the taxable supplies first exceeded £85,000.

B. Voluntary

In certain circumstances, it is possible to register on a voluntary basis for VAT even though the value of taxable supplies may never exceed £85,000. This is normally only beneficial where the majority of supplies are being made to customers who are themselves VAT registered.

The other situation in which a voluntary registration might be beneficial is where the supplies are all zero-rated and no VAT is charged on the transaction. All VAT suffered by the trader on ex-

penses can be reclaimed from HMRC.

VAT Rates

There are three rates of VAT in the UK:

1. 20% - the standard rate of VAT, applying to any sales of standard-rated goods or services

2. 5% - for certain supplies of fuel and power and sanitary goods

3. Zero-rated - the four main areas of zero-rated goods are:

- Food and agriculture (but excluding pet food and most catering)
- Printed matter, including books and newspapers
- Young children's clothing and footwear
- Passenger transport (but excluding hire cars, taxis and parking)

Any VAT charged by the business, whether at 20% or 5% is known as output VAT and the total charged or collected in the VAT quarter is payable to H M Revenue & Customs.

Input VAT

Input VAT is the VAT that you are charged on your business purchases and expenses (the other persons output VAT) and is normally recoverable in full by a trader who only makes standard rated or zero-rated supplies. Businesses that make some exempt supplies (known as partially exempt businesses) have different recovery rules. The total input VAT suffered in the quarter is deducted from the output VAT charged or collected and the difference is either the amount of VAT due to HMRC or the amount repayable by HMRC.

The majority of input VAT is recoverable but there are special rules for:

- cars
- petrol supplied for private usage;
- business entertaining;
- goods sold under a VAT second-hand scheme.

To reclaim VAT you have been charged as input VAT, you must hold valid evidence that you have received a taxable supply, which normally means a valid VAT invoice from a registered trader showing his VAT number and the amount of VAT charged.

Quarterly returns

As mentioned earlier, as part of the Making Tax Digital project, all VAT registered businesses above the registration threshold will need to keep their accounting records in a digital format and update HMRC quarterly from April 2019. Currently most businesses manually input their VAT details and are not required to maintain computerised accounting records.

Penalties

There are penalties for errors in VAT returns.

Treaties for the avoidance of double taxation

Such treaties are also known as double taxation agreements and are an agreement between two countries under which the taxation authorities of each grant tax concessions or reliefs to prevent taxpayers being liable for tax on the same amount under both systems and to lower the withholding tax payable in one country on dividends, interest and royalties paid to a person in the other country.

These treaties are incorporated into UK domestic laws by statutory instruments made under section 2 of the Taxation (International and Other Provisions) Act 2010 (section 788 of the Income and Corporation Taxes Act 1988 for accounting periods ended on or before 31 March 2010.)

The UK has a large number of double taxation agreements with many countries, but these usually only cover income taxes, corporation taxes, capital gains taxes and petroleum revenue taxes.

Benefit distribution (national withholding taxes, international tax exemption options)

UK companies are not required to withhold tax from distributions to shareholders, wherever those shareholders are based and whatever their legal status.

UK companies are required to withhold tax at 20% from most payments of interest or royalties made to individuals or companies resident outside the UK. In many cases, withholding tax on payments to individuals and companies outside the UK can be reduced under the terms of an appropriate double taxation treaty.

In some cases, where payments are made to related companies within the European Union, withholding taxes can be removed under the EU Interest and Royalties Directive. Depending on the terms of the UK's departure from the EU, it may be necessary to reassess the tax position of interest or royalty payments where the Directive has been used to remove withholding taxes and to seek relief under an appropriate double tax treaty.

Tax treatment of losses

The tax treatment of losses incurred by companies has been significantly revised with effect from 1 April 2017. It should be noted that losses arising on capital transactions are dealt with in a different way from losses arising on revenue items.

Revenue losses arising after 1 April 2017 can be used flexibly to cover profits from any source in the company generating the losses or in other companies within the same group. This relief is available for losses in the year that they arise, in the prior year and in subsequent years if those losses are carried forward.

Losses arising before 1 April 2017 can be carried forwards against profits arising in the same company but cannot be used against profits of other group members. Also, relief for these losses may be restricted to certain classes of profit depending on the original source of the loss (e.g. trade, investment business, property business).

Losses carried forward by a company do not expire with time, but losses will expire if the company ceases to carry on the activity that gave rise to the losses or if the ownership of a company changes and the activities that gave rise to the losses undergo a material change within the three years before or five years after the change.

A company is entitled to use brought forward losses (whenever arising) to fully relieve the first £5million of profits arising in a subsequent year. However, only half of any profits over £5million can be covered by brought forward losses. A group of companies is only entitled to one allowance of £5million shared between all group members.

Capital losses of companies can be carried forward indefinitely and used against future capital gains of the company and, in some cases, of other members of the same group.

Employment obligations (salary taxes, social security)

Irrespective of the form of business operated, if a business has employees, then it will have to contend with payroll taxes. Directors of a limited company are also employees.

Not only does the business have to collect and remit pay as you earn (PAYE) to the Collector of Taxes on behalf of HMRC, but it will also need to operate the sick pay scheme and maternity pay scheme. The PAYE scheme must be run in accordance with UK legislation and should a business fail to comply then HMRC will look to the employer for the tax or NIC it failed to deduct. This can be costly if the business is unable to recover the tax and NIC from the employee.

Whether an individual is an employee or not in a particular situation is a question of fact depending on the terms on which he or she works. The question of whether an individual is employed or self-employed is very important for the business "employing" him or her, as that business has to comply with the reporting requirements.

The "employer" should not just accept that the worker says he is "self employed". In certain areas HMRC has placed emphasis on reclassifying individuals claiming to be self-employed.
If doubt exists as to the status of an individual, the situation can be clarified with HMRC.

The Operation of PAYE and Real Time Information

Most businesses operate a computerised payroll system. A system of Real Time Information (RTI) has been introduced which will allow businesses to submit information electronically to HMRC every month. A business will need RTI-enabled software and this can be provided by several software companies.

Alternatively, where there are 9 or fewer employees a business can use HMRC's Basic PAYE Tools which can be downloaded from the HMRC website. The tax and national insurance should be paid to HMRC by the 19th of the month following that in which the salaries were paid (22nd of the month if paying electronically).

Under RTI, the employer tells HMRC about tax, NICs and other deductions when or before the wages and salary payments are made, instead of waiting until the end of the tax year. It is hoped that this system will make the PAYE process simpler and less burdensome for employers and HMRC. It removes the need for the end of year return on P35 and P14, although the end of year form P60 still has

to be prepared and given to employees.

RTI also simplifies the employee starting or leaving processes.

Pensions Auto Enrolment

Recent changes to Pensions legislation require all employers with 2 or more employees to provide a pension scheme for their employees. This “Auto Enrolment” is already an obligation for medium-sized and larger firms with 50 or more employees. There are some exceptions and additional procedures for businesses to follow so please seek professional advice.

For automatic enrolment there are minimum pension contributions that must be paid in order to comply. From 6 April 2019 the employer minimum contribution is 3% and the total minimum contribution is 8%.

A worker may also wish to pay additional pension contributions, which a business will need to make sure is deducted and paid to the scheme on time.

After automatically enrolling employees, the employees may ask to ‘opt out’ of the pension scheme. The business must then stop deductions of contributions and arrange a refund of any contributions paid to date.

Benefits in Kind

In most businesses, the directors, and often the employees, have benefits that are not immediately taxed through the PAYE system, the most usual being the provision of a car and possibly fuel.

Form P11D

This needs to be completed in respect of benefits in kind and reimbursed expenses for employees and company directors, unless the following apply:-

You have registered for voluntary payrolling of benefits

Benefits in kind can be deducted through the payroll, so the tax is collected through their payroll, rather than an employee’s PAYE tax code. Note, if the employer has not registered before 6 April 2018, then Forms PllD will need to be completed.

Expenses exemption

The employer does not need to apply for a dispensation or report the expenses on a Form PllD where an expense is paid or reimbursed and the employee is entitled to claim a full matching deduction (i.e. incurred wholly, necessarily and exclusively for business purposes). However you are required to keep proper records and have systems in place to meet HMRC requirements.

Form P11D(b)

This needs to be completed, for benefits in kind including those deducted through the payroll and taxable expenses where applicable, in order to report the Class lA National Insurance payable.

Penalties

The above forms must be submitted by 6 July 2019 to avoid any penalties. Forms PllD - the penalty may be up to £300 per document, plus a further £60 per day until the return is submitted. In addition, any incorrect PllD form submitted carries a penalty of up to £3,000 per document.

Form PllD(b) - minimum penalty of £100 per 50 employees for each month or part month. If the failure continues beyond 12 months, then there will be an additional penalty equivalent to the amount of Class lA NIC unpaid at the filing date. Class 1A NIC is payable by 19/22 July 2019, the latter applying if the liability is settled electronically.

In view of the above penalties, it is important to ensure that the Forms P11D and P11D(b) are completed correctly and filed within set deadlines.

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