

Business forms

A brief guide to the options for starting up



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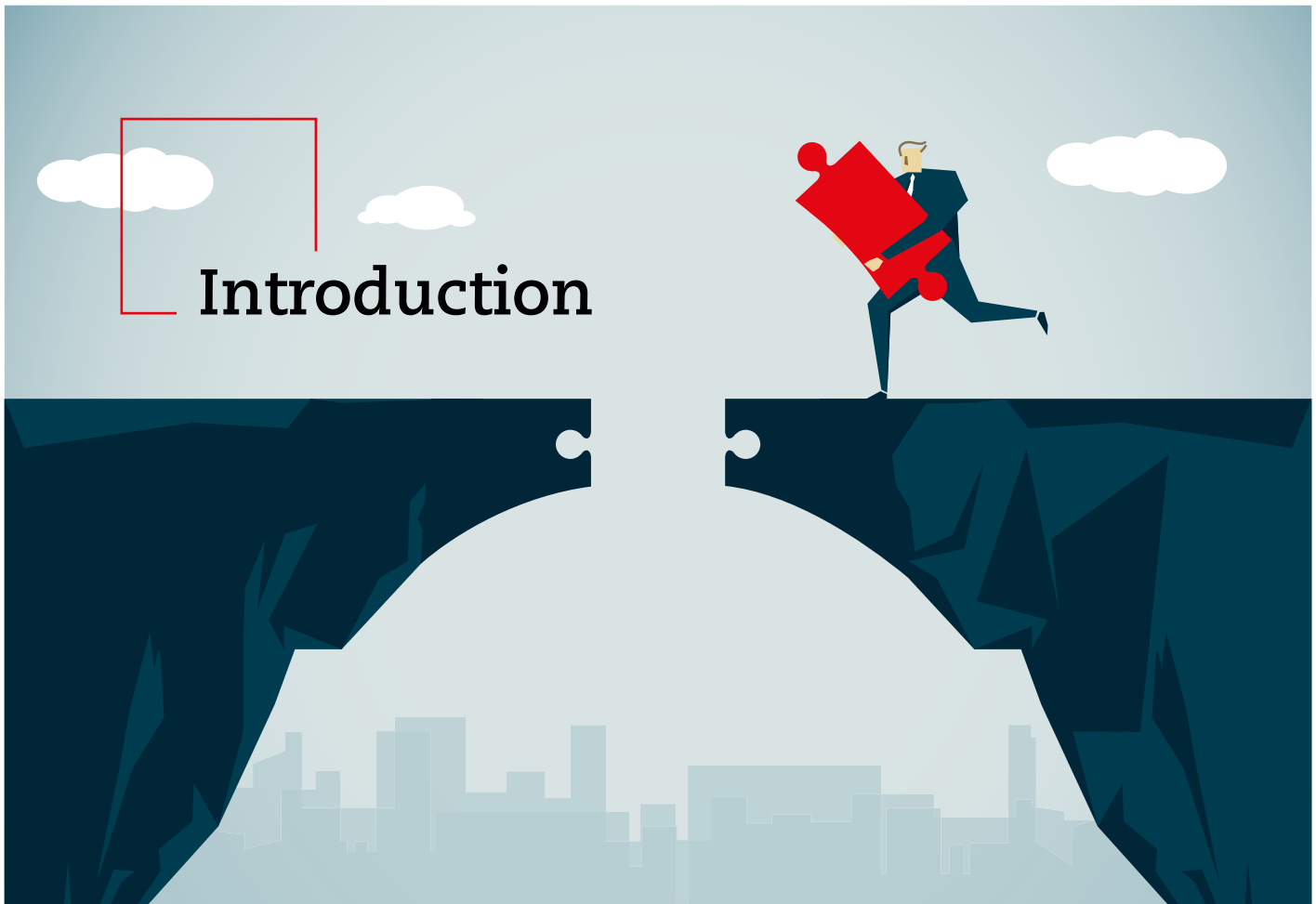
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About this report

Business activities are an essential part of every society. Their success, especially when first starting up, depends on many social and economic variables, but one of the most important things is what legal form the business adopts. Long-term success and prospects, through relationships with suppliers, investors and customers, can be hugely affected by the structure chosen. This guide sets out some of the common forms, and some issues that business founders and their advisers should consider.



Introduction

Business activities are an essential part of every society. Their success, especially when first starting up, depends on many social and economic variables, but one of the most important things is what legal form the business adopts. Long-term success and prospects, through relationships with suppliers, investors and customers, can be hugely affected by the structure chosen. This guide sets out some of the common forms, and some issues that business founders and their advisers should consider.

The legal form adopted for any business venture will affect what it can do and how it can do it. As well as the rights and responsibilities set out in law, the form of the business can also affect how customers, suppliers and investors behave towards it. It is important that the choice of form is based on the appropriate factors.

This guide sets out a summary of the most common legal forms available at the time of writing and the main attributes that will usually influence the choice of form. It is not a detailed guide, and cannot replace specific advice from an ACCA-qualified accountant tailored for your particular circumstances.

It is designed as an introduction to the important factors to help entrepreneurs and their advisers have an informed conversation about the available options.

You will need to consider where your business is in its life cycle at the moment and where you want it to go – are you planning to grow, and if so how quickly? If not, are you trying to build a business to sell, or perhaps to hand down to your children? What is the normal model in your sector, and why? Are the reasons why everybody else has adopted a particular format relevant to you, or is your business unusual in some way that suggests a different approach?

You do not necessarily need to do vast amounts of research, but whatever stage your business has reached, you need to be happy that you are using the right structure for it – time spent thinking now could save you a lot of time, money and effort in the future.

In order to simplify the analysis, the characteristics of business forms have been split into four tables, considering in turn: Realising the returns, Investing into the business, Legal characteristics, and Administrative requirements.

Realising the returns



Most businesses are run with a view to creating a profit for the investors (whether owners, managers or lenders), but there can be other motivations, such as providing community services or wider public benefits, which might restrict the range of business vehicles available. The long-term goal may be financial security for the founder and their family or partners, or it could be to maximise profitability with a view to sale.

Deciding what 'value' is for the business, and then how best to ensure that the value ends up where it is supposed to be, is perhaps the most important consideration when deciding on form. Some structures favour regular extraction of accrued profits; others allow for the sale of a share, and future returns on that share, to a third party.

Whenever money is realised, there are likely to be tax consequences, and while it is rarely if ever a good idea to allow business form to be driven by tax, at the same time it is important to factor in the impacts of the tax system on your business when deciding how to structure it.

Investing into the business



You must consider whether or not you need to raise money to develop the business. If the founders need more start-up funding than they personally have available then the simplest way to introduce money to the business is often to borrow it, which will involve paying interest.

Typically, the cost will be based on how much you borrow, regardless of how much profit you make. For a corporate body, however, there is also often scope for raising money as equity, so that the investor receives a return only if the business actually makes a profit. There may be other sources of funding, such as government grants, which are often targeted at smaller firms, and again, as with realising returns, it is important to understand the tax impacts of different funding models.

Legal characteristics



Will the business need a separate legal identity from its owner(s)? That is, will it need its own identity, and the capacity to own things in its own right? Or can everything be held in the legal name of the owner?

Companies and other 'bodies corporate' exist as independent legal entities, able to enter into contracts and enforce (or be subject to) rights and liabilities. That contrasts with the sole trader's position, where everything is done directly in the name of the individual responsible. In addition, use of a separate legal personality can greatly simplify selling, or transferring, part or all of the business.

It is worth bearing in mind that courts might sometimes look behind the company (sometimes known as behind the 'corporate veil') to hold owners or directors personally liable, usually where there has been criminal activity. On the other hand, in many jurisdictions there are personal bankruptcy safeguards that protect the entrepreneur from total ruin in the event that unexpected liabilities arise.

ADMINISTRATIVE REQUIREMENTS

Often driven by the legal characteristics, these tend to fall into two categories – occasional requirements, such as the formalities around the initial start-up or major transactions such as a sale of the business, and regular requirements such as preparing and filing or publishing accounting information, or observing certain formalities around transactions, for example dealings between the investors and other stakeholders, such as managers or employees.

Starting the business is something that happens only once. The legal form you choose should be based on long-term factors, not just the ease of the start-up process. It is important, nonetheless, to understand what needs to be done, how long it will take and what it might cost.

Some broader considerations



TRANSPARENCY

There is often a trade-off between the level of rights or freedoms a business vehicle has and the amount of information about itself that it has to make public. The link is sensible – for example, where companies can raise money from the general public through ‘listed’ securities they have to publish considerable amounts of legal and financial information so that investors can make an informed decision. Likewise, entities that enjoy limited liability are usually required to report or publish financial information so that potential creditors can understand what limits there might be on recovery if they do enter into a financial relationship with the business. The disadvantage is that there can be concerns about divulging commercially sensitive information, or even personal details about owners or managers.

ACCOUNTABILITY

The rights that a business has, for example to protect its name or enter into contracts, are usually reflected in the responsibilities it has for filing accounts or maintaining reserves for its creditors. Such responsibilities will be reflected in running costs and earning opportunities, as well as the obligations the business has for paying taxes. The mechanisms that society has to hold the business to account for its actions, whether in respect of investors, creditors, employees or customers, may vary depending on the business form. The extent to which investors are liable for the debts of the business is often linked to the level of formality involved in setting up and running the undertaking, and the transparency of its operations.

Detailed tables of business types/features

Use the tables below to help you decide what characteristics your business requires or those that you are willing to accept in return for particular advantages.

REALISING THE RETURNS

	Primary goal of structure (financial success, or "other")	Entity liable to tax	Participants taxed on flow through basis	Mechanisms for profit distribution ¹	Mechanism to retain profit untaxed for reinvestment
Private Limited Company (Pte Ltd)	Profitable trading/ investment	Yes	No	Primarily dividend (income) or return of capital to investors (usually on winding up)	Distributable reserves retained in the company can be reinvested in future years
Public Company Limited by shares (Ltd)	Profitable trading/ investment	Yes	No	Primarily dividend in accordance with rights of share class (income) or return of capital to investors (usually on winding up)	Distributable reserves retained in the business can be reinvested in future years
Public Company limited by guarantee	Typically used for "non-profit" and charity work.	Yes	No	Distribution of profits possible but rare (and may compromise any charitable status)	Distributable reserves retained in the company can be reinvested in future years
General Partnership	Typically financial venture	No	Yes	Profits shared between partners in accordance with agreement	None – all profits taxed on partners in the year they arise
Limited Liability Partnership	Typically financial venture	No	Yes	Profits shared between partners in accordance with agreement	None – all profits taxed on partners in the year they arise
Limited Partnership	Typically financial venture	No	Yes	Profits shared between partners in accordance with agreement	None – all profits taxed on partners in the year they arise
Sole Proprietorship	Financial returns	No	Yes	Retained by the individual	n/a

¹ The existence of mechanisms to distribute profits.

INVESTING INTO THE BUSINESS

	Can the business borrow?	Access to expansion funding ²	Availability of tax incentives	Availability of government grants
Private Limited Company (Pte Lted)	Yes	Yes	Yes	Yes
Public Company Limited by shares (Ltd)	Yes	Yes	Yes	Yes
Public Company limited by guarantee	Yes	Yes	Yes	Yes
General Partnership	No	Limited	No	Yes
Limited Liability Partnership	Yes	Yes	No	Yes
Limited Partnership	No	Limited	No	Yes
Sole Proprietorship	No	Limited	No	Yes

Note: Tax incentives tend to be based on business sector rather than form

² Expansion funding means long term introductions of capital investment, which is limited for those partnerships where the only route is injection of funds through increased partnership shares.

LEGAL CHARACTERISTICS

	Incorporated	Separate legal personality	Limited liability for participants	Can you sell a share in the business? ³
Private Limited Company (Pte Lted)	Yes	Yes	Yes	Yes
Public Company Limited by shares (Ltd)	Yes	Yes	Yes	Yes
Public Company limited by guarantee	Yes	Yes	Yes	Yes
General Partnership	No	No	No	No
Limited Liability Partnership	No	Yes	Yes	No
Limited Partnership	No	No	Partly	No
Sole Proprietorship	No	No	No	No

³ The ability to transfer a partial interest without the business ceasing to exist.

ADMINISTRATIVE REQUIREMENTS

	Legal requirement to prepare accounting information ⁴	Legal requirement to publish accounting information	Legal requirements re internal dealings between directors and members	Identity of participants publicly available ⁵	Cost of maintaining the business form ⁶
Private Limited Company (Pte Ltd)	Yes	Limited	Yes	Yes	\$60
Public Company Limited by shares (Ltd)	Yes	Yes	Yes	Yes	\$60
Public Company limited by guarantee	Yes	Yes	Yes	Yes	\$60
General Partnership	No	No	No	Yes	\$30
Limited Liability Partnership	Yes	No	No	Yes	\$30
Limited Partnership	No	No	No	Yes	\$30
Sole Proprietorship	No	No	No	Yes	\$30

Note: Smaller Pte Ltd companies (Exempt Companies and Small Companies) have a reduced administrative burden, including exemption from audit.

There is a fee (currently \$5.50) for accessing BizFile information

⁴ Refers purely to financial information. Many forms have other reporting obligations, in particular charities, which should be considered.

⁵ In line with international trends, where one or more individuals hold a significant element of control over the business their identity must be reported to a central regulator and is publicly available. Please note that business transparency is one of the fastest developing areas of law and particular care should be taken to confirm the current position.

⁶ Only refers to the fixed filing costs that are necessary to pay to maintain the particular business form. There are a number of variable costs involved that should also be considered.

