



## :: Starting Your Business – Legal Structure

An important question for every business is the legal framework under which the business should operate. Should it trade as an unincorporated business? Or should it incorporate a private limited company? In this article, we examine the differences in the legal framework and explore the merits of forming a private limited company.

### Partnership

If a business is not presently incorporated and a number of business partners own the business, it is likely that the business will operate as a partnership. A partnership is an important legal concept as there is a body of partnership law which would apply, even though the promoters may not be aware of this. The law provides that a partnership exists if persons carry on in business in common with a view to profit. The body of partnership law, some of which dates back to the 1800s, will then automatically apply to the partnership whether or not this was intended or not. In For example the law provides that if one partner leaves the partnership whether by retirement, death or simply leaving the business, the entire partnership has automatically dissolved. This would obviously be a strange situation as the remaining partners would often be unaware that this is the case.

In this situation, it is generally prudent for the partners to formally agree the terms of the partnership, rather than being at the mercy of old laws. The partners can agree a partnership agreement to govern the relationship between them.

### Necessity of a Partnership Agreement

A partnership agreement will typically contain details of the capital contributed by each of the partners, and the exact proportions in which any profits or losses of the partnership are shared amongst the partners. This is important where the business operates from a premises owned by one of the partners in a personal capacity. It would be crucial for this to be covered in a legal agreement to ensure that is clear that the premises is not partnership property. If the business did run into severe difficulty and creditors attempted to force the sale of partnership assets, the partners (and more importantly whoever actually owns the property) can show that the premises was not in fact partnership property.

The partners can agree that the partnership does not automatically dissolve if a partner leaves, and instead agree what happens in this eventuality. Provision could be made for valuation

of the share of a partner who decides to leave the partnership. This avoids valuation disputes at a later date.

### Liability of Partners for Partnership Debts

A significant disadvantage of operating a business through a partnership is that by law partners are jointly and severally liable for any debts of the partnership. This means that one partner could be liable for all of the debts, even though that partner may have had nothing to do with the day to day running of the business. The partners can agree amongst themselves that each partner is only liable for their respective share of the partnership. Although this would not protect partners from third parties, it would just mean that if a single partner was sued for the debts of the partnership, he or she could have recourse against the other partners.

A partnership agreement could also set out set out how decisions are to be made by the partners and provide for an obligation to keep any partnership assets completely separate from assets of the partnership.

### Private Limited Company

The second most common form of legal structure for a business is the private company limited by shares. There are a number of different types of limited companies (such as public companies listed on a stock exchange) but the private company limited by shares is by far the most common.

If the owners of a business choose to incorporate a company limited by shares, they can avoid a number of the problems outlined above with partnerships. Each of the owners of the business (that is the shareholders) would own shares instead of a certain share of the partnership. It is that it is easier to transfer a person's shares in a company, as a person could simply sell their shares in the company. Contrast this with a partnership where the person selling his share would have to identify exactly which assets form part of the partnership, then actually value the share owned by that person, and then decide which of the partnership assets form part of that person's share. Tax is another important distinction. If an individual were to sell his shares in a company, the buyer would be liable for stamp duty of 1% on the transfer of shares. However, the sale of an unincorporated business may attract stamp duty at normal rates (i.e. 9% if over €150,000). Therefore, if you have any intention of selling the business down the line, incorporation is strongly advised.





Another advantage of a private company is that each of the shareholders have limited liability. Each shareholder can only ever be liable for the amount the person has invested in the company. A company is a separate and distinct legal entity to each of its shareholders and accordingly an individual shareholder cannot be held personally liable for debts of the company. Individuals have limited risk if the business fails. This advantage would sometimes be eroded if individual shareholders give personal guarantees to banks in order to secure borrowings for the company.

### **Incorporation of Limited Company**

Incorporating a company is done through the Companies Registration Office (CRO). Companies have a number of filing requirements, the most important of which is to prepare annual accounts and file them with the Companies Registration Office. Any changes in directors, secretary, registered office, share capital, amendments to the Memorandum and Articles of Association or any mortgages or charges must be notified to the CRO. The CRO maintains a database of all registered companies, and any member of the public can search this database and access extensive information about any company. Where a business is seeking large contracts from organizations such as Government bodies or large corporations, it is usually a prerequisite that such organizations will only do business with private registered companies. Therefore, trading through a private company from the outset is advisable the business may be seeking large contracts down the line.

### **Main Distinction between Partnership and Company**

The other main difference between a company and a partnership is tax. In broad terms, when a business is conducted through a partnership each partner is taxed on their respective share of the profits for the accounting period. A limited company has two levels of taxation, the first on the company's profit and the second on money that is extracted from the company, such as by way of salary. The existence of two levels of tax in a private company, however, is often not the case as all money extracted by the owners by way of salary is deducted before the company itself computes its corporation tax. Tax is calculated the same way regardless of whether the individual receives partnership income or a salary. Therefore, the same tax rates, rate bands and tax credits often apply regardless whether the income is salary or share of partnership profits.

*This article provides and outline of the various options and proper legal advice should be sought in all circumstances.*

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