MOORE BLATCH

# CORPORATE UPDATE

Edition three

## FORMATION OF A COMPANY

STRUCTURE, REGISTRATION AND MANAGEMENT

## INCENTIVISING KEY EMPLOYEES

RECRUIT, RETAIN AND MOTIVATE

## DEVELOPING AND EXPANDING

REINVENTION, INNOVATION, MERGER OR ACQUISITION

MOORE BLATCH

# WELCOME TO THE LATEST EDITION OF OUR CORPORATE UPDATE

This is our third corporate update, a bi-annual newsletter aimed at sharing interesting articles and legal developments.

In this edition, we take a look at four key stages of the life cycle of a successful company.

1. Starting your business. What are the key considerations when making a decision to trade through a private company?
2. Early development. How can you utilise employee share schemes to motivate your key staff towards further growth?
3. Continuing development & expansion. Developing and expanding your established business.
4. Maturity. What is the legal process on returning value to shareholders or investors through the payment of dividends.

Alongside these articles we have included information about some interesting transactions we have been working on over the past year.

The Moore Blatch corporate and commercial team work with clients across a wide range of sectors, including IT, financial services, telecommunications, media, healthcare and horticulture providing sensible and pragmatic legal solutions that are commercially focused and cost-effective.

2017 was an exciting year for Moore Blatch which has seen significant growth, investment, prestigious award nominations as well as our transition to our new Southampton office in Gateway House. Moore Blatch also acquired Calvert Smith & Sutcliffe, a long established law firm based on The Green, Richmond. The merger has complemented our team and provides clients the chance to be able to access a wider range of specialisms, whilst strengthening our position in Richmond and West London.

We do hope you enjoy this edition of the corporate update and would value any feedback. If you would like to discuss any of the topics further, please do not hesitate to get in touch.

**Roger Bailey**
Partner and head of corporate
023 8071 8061
roger.bailey@mooreblatch.com

# STAGE 1 - FORMATION OF A COMPANY

Incorporating a company can be a useful strategic step for your business. As a company is the vehicle through which you operate your business, it is crucial that it is set up correctly from the outset and tailored to meet your unique business needs.

Companies can be incorporated for multiple reasons; you may be a sole trader looking to limit your personal liability, a large corporate group looking to ring fence a particular branch of your business, or a partnership evaluating options in respect of succession planning.

When forming a company, the best starting point is to evaluate and consider the most suitable type of corporate structure. Registration of a limited company creates a distinct legal personality from its shareholders and directors and therefore protects the individuals who own and run the business. However, with the role of shareholders and directors come legal obligations such as the Companies Act director duties which must be complied with.

The most common company structure is a private company limited by shares. An alternative structure is a private company limited by guarantee. The latter being more suitable to a company with a not-for-profit agenda, as the company profits should be held in reserve rather than paid to shareholders in the form of dividends.

Once your corporate structure is determined, it is key to consider the company constitution - the way in which the company is governed.

The constitution of your company is set out in the Articles of Association, which are publicly available on Companies House, and this document states the administrative and procedural rules affecting your business.

It is often advisable to put a Shareholder's Agreement in place. This is a private contract between the shareholders and the company, which regulates the shareholder relationship, ownership of shares and governance of the company. As this is a private document it is not publicly available on Companies House.

It is in these two documents (Articles of Association and Shareholders Agreement) that the power of the directors can be enhanced or restricted, the procedure for general and board meetings can be tailored and mechanisms for the valuation of shares could be included. These documents can be amended to evolve with the changing objectives or corporate direction of your business.

In terms of the management of your company, you will need at least one director and at least one shareholder, who can be the same person. The board of directors are responsible for the daily management of the company. Whilst the Articles of Association can dictate the powers available to directors, having shareholders acting also as directors is another means of asserting a high level of control over decision-making in relation to the company.

Company secretaries are not a mandatory role in a private limited company so, if required, this role can be performed by any individual in your company.

Once you have considered the elements of structure, governance and control, decisions need to be made in respect of naming the company, choosing the registered office address, choosing the accounting date and selecting auditors. This is a non-exhaustive list of further considerations. When naming your company, the name must not be confusingly similar to an existing company on Companies House. The appropriate name checks should be made prior to incorporation so you are certain the name you wish to use is available. You can change your company name after incorporation, but the same rules regarding company names still apply.

Finally, reporting obligations should be discussed with a solicitor. Companies are required to prepare annual financial accounts and file various details with Companies House throughout the year. This includes informing Companies House who the person of significant control is and under which conditions they hold this significant control.

**Milly Bygrave**
Trainee solicitor
023 8071 6125
milly.bygrave@mooreblatch.com

# STAGE 2 - INCENTIVISING KEY EMPLOYEES

**A modern employee incentive means more than just salary**

Salaries can be similar from employer to employer. An added Employee Share Incentive Scheme, however, can help recruit, retain and motivate employees.

Crucially, they can also be used to help align the interests of employees, particularly senior executives, with those of shareholders and encourage senior executives to consider the best interests of shareholders in their management of the business. This can ultimately maximise value on the lead up to an exit.

Employee Share Incentive Schemes can also help to reduce employment costs by moving part of the employees' incentive from the Pay As You Earn and National Insurance regime to the Capital Gains regime.

**What schemes and arrangements are available?**

Employee share schemes take many forms, but schemes can be divided into tax-advantaged share schemes and non tax-advantaged. For the purpose of this article we focus on the two most popular schemes, Enterprise Management Incentives (EMI Options) and Growth Shares.

**EMI Options**

EMI Options are essentially options granted to an employee to acquire shares in a company, usually at the point of exit, although sometimes it can be prior to that. EMI Options enjoy favourable tax treatment and are specifically targeted at small, higher-risk, developing trading companies.

A number of statutory requirements must be met in order for a company to qualify to grant EMI options. In particular, a company must be an independent trading company with:

- Gross assets of no more than £30 million; and
- Fewer than the equivalent of 250 full-time employees.

Certain trading activities will not qualify and there are detailed rules relating to the independence requirement, the trading requirement and the shares that can be used.

EMI Options can also be conditional on time served, or performance, or subject to a ratchet that provides that the higher the value, the higher the reward.

Where all the requirements are met, the exercise of the EMI Option benefits from favourable tax treatment which could be as low as 10% of qualifying gains if shares acquired on the exercise of EMI Options qualify for Entrepreneurs' Relief.

Importantly, it can be a condition of the exercise of the EMI Options that if the employee departs prior to exercise, the EMI Option lapses and so there is no need to put arrangements in place to ensure that shares are transferred back; or to consider the rights of the employee as a shareholder prior to exercise of the EMI Option.

## Growth Shares

Under a Growth Share scheme, an employee acquires an interest in shares upfront but the structure of the scheme is such that these shares only benefit from the increase in value in the business. That way, the existing value is reserved for the existing owners.

This structure also allows taxation at the point of issue to be low because the growth shares at that time of issue have little or no value. But at the point of exit, the shares are taxed on a Capital Gains Tax basis, which again could be as low as 10%.

## Are schemes complex and burdensome?

Employee share schemes can be as simple or complex as required but as a minimum it is important to ensure that the structure is right for the particular business, that a share scheme protects the interests of the existing shareholders, and that it achieves the tax treatment intended. Too often schemes are structured badly, meaning that more tax is payable than is needed.

Often, we can put schemes in place quickly in a simple manner, and once a scheme is in place, adding further employees can be very simple and cost effective.

## Cash bonus seems simpler?

Take an example of an employer trying to give an employee an incentive of £100,000 after tax: The employer pays a bonus and may need to gross up the amount by almost £90,000 to ensure that the employee receives £100,000. Whilst the employer may set some of those costs against its own Corporation Tax, it may also have to pay employer's National Insurance of over £25,000.

Contrast that to EMI Options where the employer may only need to gross up the amount by a maximum of around £22,000 to take into account Capital Gains Tax at up to 20% (less if at 10%). In addition, the employer may benefit from some Corporation Tax relief and would not pay employer's National Insurance.

Moore Blatch does not provide tax advice but works closely with an employer's existing (or new) tax adviser to ensure that the scheme achieves the best tax treatment. The exact tax treatment will depend on specific circumstances.

**Thomas Clark**
Associate
023 8071 6104
thomas.clark@mooreblatch.com

# TOP 10 DEALS IN 2017

### IT

**Bytes Technology Group Limited**

Leatherhead based major Microsoft LSP acquired public sector focused Phoenix Software Limited, one of the most established UK IT resellers

Deal value: undisclosed

Solicitors to the buyer

*"Moore Blatch are leaders in the field. We were delighted with the advice Moore Blatch provided us. In particular, Peter Jeffery's experience and knowledge of our sector was invaluable, along with the support of his wider corporate and specialist teams."*

**Neil Murphy,**
Managing Director,
Bytes Technology Group Limited

### IT

**Inframon Ltd**

Ensono, a leading hybrid US IT services provider, acquired Reading based specialist cloud service provider Inframon Ltd

Deal value: undisclosed

Solicitors to the management sellers

*"Our thanks to Peter Jeffery and the team at Moore Blatch in enabling this complex and important transaction to go through."*

**Sean Roberts**
Director,
Inframon Ltd

## IT

**SecureData Finance Limited**

SecureData Finance Limited, a leading cybersecurity services and solutions provider, acquired cybersecurity company, Cygnia Technologies Limited

Deal value: undisclosed

Solicitors to the buyer

*"We are grateful to the team at Moore Blatch who provided excellent legal support throughout the process."*

**Ian Brown**
Executive Chairman,
SecureData Finance Limited

## Business Services

**Coach in a Box Holdings Limited**

Sale of Coach in a Box Holdings Limited, a consultancy group offering innovative coaching services, to BTS Group AB

Deal value: undisclosed

Solicitors to the sellers

*"The legal acumen of the Moore Blatch team combined with their extensive experience providing legal advice on deals such as this played a pivotal role in bringing about this strategic move."*

**Sue Stokely**
Managing Director,
Coach in a Box Holdings Limited

## Transport

**Tructyre Limited**

Sale of TFM Holdings Limited, the parent company of Tructyre Limited, a multi brand national tyre service and fleet maintenance company, to Associated Tyre Specialists (Investment) Limited, a Michelin Group company

Deal value: undisclosed

Solicitors to the seller

*"Thank you to everyone who made this possible. I am sure there will be other opportunities in the future to work again together."*

**Glenn Sherwood**
Managing Director,
Tructyre Limited

## Media

**Chrysalis Vision Limited**

The team behind the long running Midsomer Murders franchise, who in 2014 founded Chrysalis Vision, has received a significant investment for Sky plc

Deal value: undisclosed

Solicitors to the Sellers

*"The process was extremely easy thanks to the advice and support afforded by Jeremy Over and his team at Moore Blatch."*

**Mick Pilsworth**
CEO,
Chrysalis Vision

## IT

**Blue Chip Data Systems Limited**

Sale of leading national IT services company Blue Chip Data Systems Limited to technology provider GCI

Deal value: undisclosed

Solicitors to the sellers

*"Top notch legal advice from Moore Blatch plus the commitment shown by the whole legal team enabled us to reach a deal with GCI that we are very happy with."*

**Richard Cook**
Managing Director,
Blue Chip Data Systems Limited

## IT

**Fresh Relevance Limited**

Investment in Fresh Relevance Limited, an SaaS email marketing and web personalisation platform, by Foresight Private Equity

Deal value: undisclosed

Solicitors to the company

## Electrical

**Project Bolt**

Management buy-out of leading specialist for supply, installation and maintenance of fire alarm and CCTV systems

Deal value: undisclosed

Solicitors to the management team

## Transport

**Standset Limited**

Sale of a multi-franchise motor dealership and motorhome dealership group, trading as the Freeborn Motor Group, to Jarretts Motors Limited

Deal value: undisclosed

Solicitors to the sellers

# STAGE 3 - DEVELOPING AND EXPANDING YOUR ESTABLISHED BUSINESS

You have started a company, managed the business through survival and it now exists as a viable business. At this stage your business has now firmly established its presence within the industry, is trading with both new and existing customers, and is likely to be seeing a consistent improvement in revenue, cash flow and profits.

**Reinvention, innovation, merger or acquisition**

The question becomes, what now? The next logical step for you is to endeavour to expand the business. If no action is taken, although the business could exist as a profitable business for some time, it is likely the business could stagnate and even enter decline. Therefore, you should be constantly thinking of ways to develop and grow the business.

One of the options available is to try growing the business organically. By drawing on the existing resources in the business, investing in resourcing additional people with the appropriate skills and ensuring the latest relevant technology needed for your business is in place, you look to reinvent the business or innovate from within to drive the expansion of the business. The investment needed may well require a refinancing of the business to increase funds readily available for this development phase.

If you deem reinvention or innovation an unlikely or inappropriate way of growing the business from the "steady" established phase, the alternative may well be to look at expansion through merging with a suitable competitor business or acquiring a business seen as complementing the existing business (a good "fit"). The merger combination may gain the merged companies increased market share and cost saving synergies often leading to a leaner, more efficient organisation with a larger turnover and prospects of achieving greater profitability. A strategically sound acquisition of a business which complements or extends its current offering could make the business more competitive which in turn should result in the business acquiring greater market share, increasing turnover and, in time, achieving greater profitability once the acquired business is fully integrated into the acquiring business.

Brexit and other political concerns are causing uncertainty in UK business influencing the decisions of potential investors and lenders. The long-term consequences of Brexit will not become clear for many years, and certainly not before the process of negotiating the United Kingdom's exit from the EU and the post-exit relationship between the United Kingdom and the European Union begins. However, on the positive side for those looking to expand their business, interest rates are at historic lows and debt markets are relatively cheap. Consequently the cost of funding growth through borrowing from financial institutions (such as banks) is relatively low. There is also private equity and venture capital funding available.

While focusing on developing your business to grow the customer base, market share, turnover and profits, there is always a risk of expanding too quickly and carelessly. Although, there is no crystal ball, and it is very hard to get an idea of what will be the results of your undertakings, you can give yourself the best possible chance of continued success through careful planning. Look at your resources, be realistic about the effort and cost and potential returns, and always keep an expert eye on how expansion might impact the current quality of service you provide your existing customers. Remember, while having a successful business model behind you is undoubtedly an advantage, it is not a guarantee that it will work elsewhere within other markets or that new offerings will result in the same success. The business graveyard is littered with organisations that took on too much and failed. Your task is indeed to take on new challenges as you look to constantly expand, but measure your risk and do your best to secure the business for all eventualities.

**Wayne Spolander**
Solicitor
023 8071 8090
wayne.spolander@mooreblatch.com

# STAGE 4 - RETURNS OF VALUE TO SHAREHOLDERS

## LEGAL CONSIDERATIONS OF PAYING A DIVIDEND

Once you have established a successful business, shareholders may expect to see a return on their investment. This may either be by way of a sale of their shares, or by the payment of dividends from the company.

A dividend is a distribution to shareholders of a company's post-tax profits. Dividends are usually paid in cash, but can also be satisfied by the transfer of other assets, such as property or shares (known as a dividend in specie) or by the issue of new shares in the company (a SCRIP dividend). Dividends are generally considered to be a tax efficient mechanism for returning value to shareholders, as they are taxed at a lower rate than income tax.

However, changes proposed in last year's Spring budget, which are due to be introduced in April 2018, see a reduction in the tax fee allowance on dividends. As such, whilst dividends still potentially offer a more tax efficient way of obtaining income from a business in comparison to income tax, any potential dividend income ought to be considered by individual shareholders as part of their wider tax planning, rather than being considered in isolation.

Dividends are often divided into "final" and "interim" dividends, with final dividends being paid annually following the end of the company's financial year, and interim dividends being paid at any time throughout the financial year.

When considering whether to pay a dividend, the following criteria should be considered and satisfied:

- The company must have "distributable profits" available (section 830(1) of the Companies Act 2006 ('CA 2006')). This is defined as a company's "accumulated, realised profits (so far as not previously utilised by distribution or capitalisation) less its accumulated, realised losses (so far as not previous written off in a reduction or reorganisation of capital)".

- The distribution must be justified by reference to the "relevant accounts" of the company (ss. 836 – 839 CA 2006). These are always the Company's individual accounts (as opposed to the group accounts, if any) and are usually the company's most recent annual accounts. However, specially prepared interim accounts may also be used.

- The provisions of the company's articles of association should be checked to determine how dividends should be declared. Typically, final dividends are recommended by directors but declared by the shareholders, whereas interim dividends are often declared by directors alone.

- The provisions of any shareholders agreement or investment agreements should also be checked. These types of agreement will often set out a policy as to how and when dividends should be declared (and whether shareholder approval is required).

- If there is a loan or facility in place, the provisions of the facility agreement should be checked. The facility agreement may contain a covenant preventing the payment of dividends, or may specify that lender consent is required.
  Alternatively, it may be that an amendment to the agreement can be negotiated. Similarly, if the facility is secured, any future dividends may be covered by the security, and the debenture or other security documents should also be reviewed. It may be that the security will need to be partially released or the security documentation amended before a dividend can be declared.

- Finally, the directors should consider their statutory duties to the company under the CA 2006. In particular, directors have a duty to act within their powers (section 171), to promote the success of the company (section 172) and to act with reasonable care, skill and diligence (section 174). Similarly, if the directors are also shareholders of the company (and therefore likely to benefit personally from the payment of the dividend), that may be a conflict of interest. This interest may need to be declared in accordance with the provisions of section 175, 177 and/or section182 of the CA 2006.

The consequences of authorising a dividend in contravention of the Companies Act 2006 can be serious, particularly for directors, who may be found personally liable if there were insufficient distributable profits to justify the dividend. Similarly, a director could also be liable under the Insolvency Act 1986 if the company was insolvent at the time of payment and there were no reasonable grounds for believing that the dividend payment would benefit the company. It is therefore fundamental that the above matters are considered carefully before a dividend is authorised.

We would always advise that the directors keep clear records of any board or general meetings authorising dividends, documenting the position in relation to the distributable profits of the company and setting out the justification for the dividend (with reference to the relevant accounts).

If there are any other legal documents in place (such as shareholders or facility agreements) you should also consider getting legal advice as to the ability to pay or authorise a dividend under the terms of those documents.

**Hayleigh Sears**
Solicitor
023 8071 8058
hayleigh.sears@mooreblatch.com

M O O R E  B L A T C H

w w w . m o o r e b l a t c h . c o m

Moore Blatch LLP is authorised and regulated by the Solicitors Regulation Authority.