

SMALL BUSINESS – BIG OPTIONS

A CROSS-BORDER PERSPECTIVE ON ESTABLISHING A HIGH-GROWTH BUSINESS

Stella Lellos Rivkin Radler LLP and Edward Craft Wedlake Bell LLP



CHOICES, CHOICES

Capital is international. People are mobile. Company incorporation is easy. Businesses are being set up daily.

While starting up need not be complicated, it is important to begin with the intention of succeeding. Selecting the right jurisdiction is increasingly important, particularly because the transfer of significant created value from one jurisdiction and tax regime to another becomes complicated and costly.

The U.K. has for quite a long time maintained a low corporate tax rate when compared with its OECD cousins. This has contributed towards it being used as an international holding company jurisdiction, including for some companies outside the U.S., partly because of the historic high corporate tax rate in the U.S. However, on January 1, 2018, the U.S. corporate tax rate was reduced to 21%, bringing it closer to the 19% U.K. tax rate.

Both the U.S. and the U.K. are stable environments in which to do business. New York and London remain leading markets for capital. This article explores the similarities and differences between building a growth company in the U.S. and the U.K.:

recruiting people, developing the business and its assets, and raising debt and equity.

WHERE TO ESTABLISH

The important decision of where to incorporate a business should not be determined by a tax rate arbitrage alone. Indeed, it is an important factor, but there are many other elements to consider, particularly in light of the recent U.S. tax changes that have removed the tax differential between the U.S. and U.K., and the existence of other jurisdictions such as Ireland and international finance centers that offer very low rates of corporate taxation.

It is vital to ensure that the jurisdiction and structure selected is workable and supports the business. For example, how practical is it for the directors and managers to get on a plane to the place where board meetings need to be held? How easy is it to recruit staff and maintain the required presence in that jurisdiction? The jurisdictional choice should be the consequence of an evaluation of business need, rather than the determinant of it.

The U.S. and the U.K. are logical choices. Business incorporations are easy and the cultural connections between the

two nations go beyond their common language. These jurisdictions share many similarities, including a reputation for being a comfortable place to do business, highly developed capital markets and a stable common law-based legal system. All of these factors lend themselves to supporting business certainty and trade. Both countries attract highly skilled and international labor, including the brightest, the best and those with big ideas and, as a result, each produces many start-up businesses. The data, however, points toward the U.S. being a market in which these can more easily thrive and become mega-businesses, in particular for tech startups, as evidenced by companies such as Google and Facebook, for which there are no outstanding European peers.

STRONG SIMILARITIES

Every new business begins at the same place: a person with an idea.

Long before any steps are taken to monetize and corporatize that idea, the person(s) behind it will undoubtedly devote many hours to develop the idea, exploring whether it can be built into a viable business. Two significant issues should be con-

sidered. First is the fact that the “value” of such early development is usually reflected in kind, not through a cash investment. The second is the major complication of intellectual property ownership. While it is safe to say that the development of an intangible asset funded by a company should be the property of that company, this is not the case if either the company does not exist at the time of the creation of the intellectual property or the company has not paid for its development. In order to attract future investment, it is vital for intellectual property ownership to be clear and for the relevant property to be transferred into the new company or licensed to it on a long-term, royalty-free basis.

MOVING BEYOND THE AMBITIONS OF THE FOUNDER

If a founder has all of the answers and all of the capital to deliver his vision, there is little benefit in expanding the shareholder base beyond certain key employees he or she is seeking to incentivize.

It is rarely the case, however, that the founders are able to supply all of the capital necessary to fund a high-growth business. It is at this point that the founder(s) turn to capital markets.

One of the greatest challenges for any entrepreneur is to move beyond the ambitions of the founder and for that person to cede a level of control. The founder will almost certainly be on the board, but often the entrepreneur with a great idea might not be best placed to deal with investors, employees, customers and suppliers and drive the growth story of the company as a developing business. Encouraging the founder to focus only on certain aspects is always a challenge and must be done in a sensitive manner. A founder who controls too much presents significant risks to a company, such as if he or she were to fall ill, or were to dominate the board, particularly if the founder is the CEO, developer of the asset and concept, and also a dominant shareholder. As soon as there are minority shareholders in the company, protections are needed.

THE U.S.

To incorporate in the United States, the first step is to select a name and ensure its availability in the state in which the owners wish to incorporate. A U.S. company is incorporated in a state, and that state will determine the requirements for incorporation. Delaware and New York, and at times Nevada, are the most preferred states, primarily because of the ease of incorporation, favorable taxation and the very limited in-

formation that is available to the public in the certificate of incorporation. Unlike other jurisdictions, the names and addresses of the shareholders, directors and officers, percentages of share ownership and principal place of business are not required to be made publicly available. Corporation and limited liability laws are well-established, and case law provides significant precedent.

By comparison, regardless of which part of the UK a company is incorporated in, the law is the same.

Regardless of the state of incorporation, a company may employ a person from any other state. Importantly, however, a company must apply to that employment relationship the law of the state in which the employee resides rather than the law of the state of incorporation or the state of the principal place of business.

Funding a newly formed company may be challenging if traditional bank financing is sought. More often than not, high-growth companies are funded initially through friends and family, angel investors and one or more rounds of financing in exchange for convertible notes. More recently, financial technology (fintech) companies have replaced traditional banks in providing or procuring the deployment of capital to high-growth startups.

The various states in which securities are sold may require filings if there are no SEC exemptions applicable to the sale. However, a large number of high-growth startups look to “accredited investors,” i.e., those investors that are able to satisfy certain income, net worth, asset size, professional experience or governance status requirements of the SEC.

THE U.K.

Company incorporations are easy and can be completed within a few hours by way of an online process. Once incorporated, there is a high level of transparency around the company and much information is freely available from the Companies House website.

At present, the U.K. remains a member of the European Union (E.U.) and therefore it is possible to recruit staff from across all 28 member states without need for any work permit or other immigration consent. However, the cloud of uncertainty presented by the U.K. government’s intended departure from the E.U. on March 29, 2019, without a coherent policy and strategy remains.

English company law is clear and long-established. Corporate governance principles are deeply embedded into English corporate law and practice.

In order to raise funds, it is necessary to consider laws governing financial promotions and, once public offers and/or admission to a regulated market is contemplated, the rules of the E.U. Prospectus Directive. It is much easier to raise funds from people who satisfy the test of being high net-worth individuals. While it remains vital to navigate through the regulation, no filings should be required for a growth company, save for a return to the Registrar of Companies setting out the expanded capital structure of the company. In addition, there are certain possible attractive tax reliefs for growth companies and if these are to be sought, application needs to be made to HM Revenue & Customs.

There are only three annual filings required:

- a public confirmation statement to the Registrar of Companies setting out factual matters in relation to the company, its directors and shareholders, its capital structure and ultimate control;
- accounts to the Registrar of Companies (although there is a broad audit exemption, growth companies seeking to raise funds on the market will need to procure an audit in any event); and
- a tax return to HM Revenue & Customs.

It is the combination of favorable tax rates, location of workforce, principal place of business, access to supply chain and customer base, and degree of transparency that ultimately determine the best jurisdiction for establishing a high-growth business. Each business should be assessed on its own growth and business plan. Once the foundation of incorporation is properly laid, the founders can focus on building the business and pursuing their vision.



Stella Lellos is a partner in the Corporate Practice Group in the Uniondale, New York, office of Rivkin Radler LLP.



Edward Craft is a corporate partner at Wedlake Bell LLP in London, England.

This article is based upon a presentation given by the authors at the USLAW/TELFA Cross Border Exchange held in Chicago in September 2017.