LUND ELMER SANDAGER

VENTURE CUP

HOW TO SET UP A BUSINESS IN DENMARK — BUSINESS FORMATS.

When choosing how to set up a business in Denmark it is important to know and consider what type of business format or corporate form would be most suitable for you.

No matter which company form you choose, it will however, not be binding, since it is almost always possible to transform one business form to another if you business evolves.

The text below is a guiding, non detailed description of the most common business formats in Denmark. We would always recommend that you seek the advice from our lawyers before setting up a business.

SOLE PROPRIETORSHIP (Enkeltmandsvirksomhed)

A sole proprietorship, also known as the sole trader or simply a proprietorship, is a type of business entity that is owned and run by one individual and in which there is no legal distinction between the owner and the business.

There are no requirements regarding a minimum capital of the business. The owner receives all profits (subject to taxation specific to the business - there a three different tax schemes to choose from) and has unlimited responsibility for all losses and debts. Every asset of the business is owned by the proprietor and all debts of the business are the proprietor's. It is a "sole" proprietorship in contrast to partnerships.

There is no legal regulation specific to sole proprietorships and no legal requirements as to a board of directors or a managing director of the business. The sole owner of the business has the power to bind the company, but can delegate this to employees as well.

The business is required to do bookkeeping according to the Danish Bookkeeping Act, but there are no requirements as to prepare an annual report.

The sole proprietorship is established by registration at www.virk.dk, and there are no fees involved except for any legal or accounting fees to professional advisors assisting you.

PARTNERSHIPS (Interessentskaber)

A partnership has two or more owners, either persons or corporate entities.

In a partnership every asset of the business is owned by the partnership and the partners have joint and several liabilities for all losses and debts in the partnership. The ownership in a partnership is as a rule 50/50, unless the partners agree to different division of ownership.

There are no requirements regarding a minimum capital of the business and the owners receive all profits (subject to taxation specific to the business, there a three different tax schemes to choose from).

There are no legal regulation specific to partnerships, and hence it is very important to make sure that you have a partnership contract where the terms of the partnership is described, e.g. working commitments, requirement to fund the partnership with additional capital, additional partners, preemptive rights to the partnerships share, how to solve disagreements etc.

There are no legal requirements as to a board of directors or a managing director of the business, and the partners have the power to bind the company.

The partnership is required to do bookkeeping according to the Danish Bookkeeping Act, but there are no requirements as to prepare an annual report.

The partnership is established by registration at www.virk.dk, and there are no fees involved except for any legal or accounting fees to professional advisors assisting you.

LIMITED LIABILITY/PRIVATE LIMITED COMPANIES (A/S or ApS)

A limited liability company (ApS) or a private limited company (A/S) has one or more owners either persons or corporate entities (other limited liability companies) or a combination thereof, and the ownership percentage will be determined by the amount of the owners' shares in the company.

If you are more than one owner it will be necessary to enter into a shareholders agreement that regulates the terms of your ownership e.g. working commitments, requirement to fund the company with additional capital, additional partners, preemptive rights to the partnerships share, how to solve disagreements etc.,

In both Aps' and A/S' all the assets are owned by the company and the owners have a limited liability for losses and debts in the company, limited to the company's capital. Hence, there is no personal liability for the owners. However, most banks will often ask owners of newly established companies to guarantee for loans etc.

ApS' and A/S' are heavy regulated by the Danish Companies Act.

The capital requirement for an ApS is at the moment DKK 80,000 (and might be reduced to DKK 50,000 shortly) and for an A/S DKK 500.000. The company capital can be paid in cash, but can also be made through contribution in kind (apportindskud), e.g. by contributing with the value of machinery, an existing sole proprietorship etc. The company owns all the company's assets and all profits are received by the company and the company (and not the owners are taxed). If the owner wish to withdraw profits from the company this can only be done through payment of dividends, for which the owner will be taxed.

An ApS is required to have managing director, but a board of directors /supervisory committee is not a requirement, and in an ApS a board can consist of only one person.

An A/S is required to have a managing director of the as well as a board of directors/ supervisory committee, and the Companies Act requires that a part of the companies' decisions are made by the owners on a general assembly the partners have the power to bind the company, but they can delegate this to employees as well.

The managing director is responsible for the day to day management of the company. The board of directors is responsible for the general strategic management of the company but if the company chooses to have a supervisory committee instead, they only have a supervisory function and not a managerial.

Both an ApS and a A/S are required to do bookkeeping according to the Danish Bookkeeping Act, and must as a general rule be audited by an accountant, unless the company satisfy the requirements for deselection of auditing. Regardless of auditing the company must present the Danish Business Authority with an annual report.

The Aps and A/S are established by a formal procedure with signing of articles of incorporation and articles of association for the company and if the capital is made by contribution in kind an auditor's assessment report is also a requirement. You can register an ApS or A/S at www.virk.dk, and the fee is DKK 670 if you choose to do it online and DKK 2,150 if you send in a form by ordinary mail. When establishing an A/S or ApS we recommend that you seek legal advice.

LIMITED PARTNERSHIP COMPANIES (P/S - Partnerselskab/Kommanditaktieselskab)

A P/S is a combination of an A/S and a K/S (another legal form of a limited partnership). To establish a P/S there is a requirement of two or more owners, either persons or corporate entities.

A P/S has two types of participants/owners. At least one general partner (komplementar) and at least one limited partner (kommanditist). The general partner (and this can be both a person or an A/S or ApS) has a individual, primary, unlimited liability and the limited partner has limited liability and is usually an A/S or ApS, where all the shares have been invested in the P/S.

The capital requirement for a P/S is minimum DKK 500.000. The company capital can be paid in cash, but can also be made through contribution in kind (apportindskud), e.g. by contributing with the value of machinery, an existing sole proprietorship etc. The capital can either be paid in full by the limited partner(s) and the general partner can choose to pay a part of the capital but is not — unlike the limited partner — obligated to do so.

A P/S is regulated by the Danish Companies Act with the necessary modifications, but the rules governing the management, capital requirements, capital increase etc. are the same.

The management of the P/S can either be performed by the general partner, with a board of directors appointed by the limited partner(s) supervising the general partner. Alternatively the management of the P/S can be performed through the limited partner's management, e.g. by appointing the general partner as the managing director.

Even though the P/S is regulated by the Danish Companies Act, it is taxed very differently. A P/S is just as a sole proprietorship and partnership transparent from a tax point of view, and is not encompassed by the companies tax act. Hence, the general and limited partners (and not the P/S) are taxed for the P/S earnings or losses. For a start-up company, with a potential deficit the first couple of years, this can be a big advantage for the partners in the P/S, since they can deduct their part of the deficit in their personal/company income. Hence the company format was actually also thought out to be of particular interest for start-up companies.

If you are more than one limited partner it will be necessary — just as in an A/S - to enter into a shareholders agreement that regulates the terms of your ownership e.g. working commitments, requirement to fund the company with additional capital, additional partners, preemptive rights to the partnerships share, how to solve disagreements etc.,

A P/S is required to do bookkeeping according to the Danish Bookkeeping Act, and must as a general rule be audited by an accountant, unless the company satisfies the requirements for deselection of auditing. Regardless of auditing the P/S must present the Danish Business Authority with an annual report.

P/S is — just as an A/S - established by a formal procedure with signing of articles of incorporation and articles of association for the company and if the capital is made by contribution in kind an auditor's assessment report is also a requirement. You can register a P/S at www.virk.dk, and the fee is DKK 670 if you choose to do it online and DKK 2,150 if you send in a form by ordinary mail. When establishing a P/S we recommend that you seek legal advice.

If the general partner and the limited partner becomes the same corporate entity or person, the P/S must either go into liquidation or have a new general/limited partner enter into the company.

FROM ONE CORPORATE/BUSINESS FORMAT TO ANOTHER

Both sole proprietorships and partnerships can be converted into an ApS or A/S, and an ApS can also be converted to and A/S as well as the other way around. A sole proprietorship is automatically considered to be a partnership, when a partner enters and there is more than one owner, just as a partnership also turns into a sole proprietorship if only one partner is left.

In the same way a P/S can be converted into an A/S and the other way around.

When transforming a sole proprietorship or partnership into an ApS or A/S the value of the business can be used to meet the capital requirements through contribution in kind, as mentioned above. A transformation can be made either tax free (on specific terms) or taxed just as it is possible over time to establish a holding company structure for an ApS or A/S through an exchange of shares (either tax free or taxable)

In that way the legal structure of the business can grow over time in accordance with your developing business and your wishes.

ADVANTAGES

SOLE PROPRIETORSHIP

- It is easy to organize and needs only the amount of capital that you decide is sufficient
- Low degree of formality regarding decision making and management/board
- It permits a high degree of flexibility for the owner since he/she is the boss of the business establishment
- Due to its unlimited liability, some creditors are more willing to extend credit
- The owner gets all the profit of the business due to direct relationship and it is easy to withdraw from the business

PARTNERSHIPS

- Same advantages as with a sole proprietorship
- With more than one owner, the ability to raise funds may be increased, both because two or more partners may be able to contribute more funds and because their borrowing capacity may be greater.
- Prospective employees may be attracted to the business if given the incentive to become a partner
- A partnership may benefit from the combination of complimentary skills of two or more people. There is a wider pool of knowledge, skills and contacts
- Partnerships can be cost-effective as each partner specializes in certain aspects of their business. Partnerships provide moral support and will allow for more creative brainstorming.

A/S - APS

- Limited liability for the owners and separation from the owner's personal funds and economy
- Well known company form and highly regulated

- Offers a well known and secure business format for creditors and investors
- If the firm fails it can be closed down either by liquidation or bankruptcy without (or with small effect) on the owners personal property and economy
- The shares can be sold and bought fairly easy which is desirable if you have an exit-strategy for your company or have plans for a generational handover
- If owned jointly some of the partnership advantages will also be advantages her

P/S

- The best of "two world" - Limited liability for the owners (limited partners) and transparency from a tax point of view, with a possibility to deduct the partners share of the P/S deficit in the partners personal income
- Regulated by the Danish Companies Act
- Offers a secure business format for creditors and investors, because of higher creditworthiness due to the combination of both personal and limited liability
- Possibility to have "sleeping partners"
- If the firm fails it can be closed down either by liquidation or bankruptcy without (or with small effect) on the partners' personal property and economy, since a general partner can also be a limited company.
- The shares can be sold and bought fairly easy which is desirable if you have an exit-strategy for your company or have plans for a generational handover
- If owned jointly some of the partnership advantages will also be advantages here

DISADVANTAGES

SOLE PROPRIETORSHIP

- Raising capital for a proprietorship is more difficult because an unrelated investor has less peace of mind concerning the use and security of his or her investment and the investment is more difficult to formalize. Because the enterprise rests exclusively on one person, it often has difficulty raising long-term capital
- Other types of business entities have more documentation and more regulation
- The business may be crippled or terminated if the owner becomes ill. Since the business is the same legal entity as the proprietor, it ceases to exist upon the proprietor's death
- Has limited resources. Banks are reluctant to grant loans to single proprietorship considering its small assets and high mortality rate
- Unlimited liability for business debts. The single owner is responsible for paying all debts and damages of their business
- If the firm fails, creditors may force the sale of the proprietor's personal property as well as their business property to satisfy their claim
- It is easy to mix-up the business economy with the owners economy

PARTNERSHIPS

- Same disadvantages as sole proprietorships
- Business partners are unlimited, jointly and individually liable for the actions of the other partners

- Profits must be shared with others. You have to decide on how you value each other's time and skills. What happens if one partner can put in less time due to personal circumstances?
- Since decisions are shared, disagreements can occur. A partnership is for the long term, and expectations and situations can change, which can lead to dramatic and traumatic split ups
- The partnership may have a limited life; it may end upon the withdrawal or death of a partner
- A partnership usually has limitations that keep it from becoming a large business
- You have to consult your partner and negotiate more as you cannot make decisions by yourself. You therefore need to be more flexible

A/S - APS

- Capital requirements
- High degree of formality and regulation both regarding general assembly decisions and payment of dividends, which in other words mean a lot of paperwork
- Costs involved with accounting and lawyers fees
- Both the company and the owners pay tax (double taxation)
- If owned jointly some of the partnership disadvantages will also be disadvantages here

P/S

- Not a well known corporate form and often confused with a K/S, a company format with a mixed reputation
- High capital requirements
- High degree of formality and regulation both regarding general assembly decisions and payment of dividends, which in other words mean a lot of paperwork
- If owned jointly some of the partnership disadvantages will also be disadvantages here
- Less flexible than an A/S or ApS with respect to change in ownership, since there is a requirement of at least 2 partners.

May 02, 2013

If you wish to know more about the different business formats and what type would suit your needs please contact Attorney-at-Law Pernille Ørskov, pni@lundelmersandager.dk