BUYING A SUCCESSFUL BUSINESS

It is important that the business structure selected is the most appropriate for the business operation being run.

The structure appropriate for an independent single vehicle operator may not be suitable for a fleet operation.

In this issue of the Truckers' Guide to the Law, a brief summary is made of the various business structures together with brief comments on some of their advantages and disadvantages.

It can be a complex area. Anyone interested in establishing or examining their business structure should seek appropriate specialised legal advice.

Three Basic Forms of Business Structure

The three most common structures for a business are:

- sole trader;
- partnership; and
- company.

Sole Trader

This involves an individual trading either under his or her own name or a trade name; i.e. Jack Spratt Carriers or J. Spratt trading as Spratt Carriers. There are no registration or documentation requirements to commence trading in this capacity except the usual taxation, GST and revenue requirements. The GST registration is probably the most important first step of all the Inland Revenue Department requirements. The sole trader is personally responsible for all business debts and any profit made by the business is taxable income in the sole trader's hand.

Partnership

A partnership consists of two or more people carrying on the business jointly trading under a partnership name. All of the partners are jointly and severally liable for all of the partnership debts. Any profit made by the partnership is divided in accordance with the rules of the partnership, which rules may be oral or in writing.

A written partnership agreement drafted by an experienced lawyer will usually cover many possible areas of concern which an oral agreement often overlooks. The written record, too, is more reliable than the oral recollection when the partners wish to clarify their rights and obligations.

There is no set form to a partnership agreement or any requirement that the agreement cover any particular issues. However, well drafted agreements often cover issues such as the amount of capital that is to be contributed, arrangements for future obligations to contribute capital, what is to happen to the assets of the partnership if and when it is dissolved, how any profit is to be distributed amongst the partners, and the business duties of all of the partners.

Company

Unlike a sole trader or a partnership, the formation of a company creates a separate legal entity distinct from its directors, who are often the owners. This separate entity splits the trading activity of the company away from the directors and insulates them from the business debts (unlike a partnership). A company which confers limited liability on its directors records that fact by including the word "limited' as part of its official name.

The company is bound by its own rules and the Companies Act 1993, and in some circumstances must be considered to have "a mind of its own" with separate rights and obligations to those of its directors. Unlike a partnership, a company cannot be dissolved or cancelled by will or by notice in accordance with its rules – it can only cease to exist if the strict procedures under the Companies Act are followed.

Which Business Structure is Most Appropriate?

Limited Liability

The 'protection' of limited liability provided by a company to the directors is, in practice, very much reduced. Usually lenders and landlords will require personal guarantees of the company's obligations by the directors. Sometimes even trade creditors these days ask for directors to guarantee trade accounts.

However, liability for directors is not automatic and requires a conscious step in providing a guarantee. Directors do not automatically assume personal liability for the company's debts (unlike partners in partnership), unless their actions breach standards and duties imposed on directors by the Companies Act. In a very general sense, directors will not be personally liable for the company's debts unless they act recklessly, or make a conscious decision to personally guarantee a particular contract or debt.

Name and Identity Protection

By registering a company that registration offers an exclusive right to that exact name against any other company wishing to incorporate. Partnerships and sole traders however have no central record or registry to record their business name. The Fair Trading Act provides protection of business names from similar names that may be misleading. This applies to both companies, partnerships and sole traders who all rely on the Fair Trading Act or the common law rules of passing off to prevent unauthorised use of the same or a similar name.

Trade mark registration, which is available to all business entities, protects marks (which may be names) in respect of certain goods, or classes of goods and services.

Financing

Lenders of money or credit usually require security for the advance or accommodation. While land is probably the easiest asset charged as a security and the asset most preferred by lenders, not every company, partnership or sole trader may have land available to offer as security. If land is not available, then a lender must be persuaded to accept as security for the advance or accommodation, the other assets of the business which may be vehicles, book debts, other items of equipment or the general goodwill of the business. This can be achieved by a general security agreement over all of the company's assets and registered on the Personal Property Securities Act's security register.

With one document, a company can give a security over all of its assets and even grant successive securities to different lenders, regulating their priority. This cannot be achieved so simply by a partnership or sole trader over all of the assets of the business, and hence from a lender's perspective, the security offered by those trading entities can be less desirable than that of a company.

Income Tax

A company has a flat rate of tax on all taxable income. Individuals face a progressive tax rate.

Individuals also can have the initial rate of tax softened by special provisions such as family support. Those provisions are not available to companies. In practice however, small private companies are able to ensure that the shareholders get the benefits of any lower individual rate of tax by paying out the profits as salary or wages to the working shareholder. Hence, for practical purposes, those companies may not make any profit at all, and all income is in fact derived by the working shareholders.

A partnership does not have a separate income taxable entity, and the profit is divided between the partners in accordance with the partnership agreement. That divided income is then treated in the same way as a sole trader for tax purposes or a working shareholder who has all of the company's profit paid out by way of salaries.

Some differences do exist if GST and other forms of taxation are considered. A partnership for GST purposes is treated the same as a company and has its own GST entity separate from the individual partners.

Cost of Structure

A company is a legal entity registered under the Companies Act. As such, the filing fees on incorporation and the annual fees must be paid. A partnership or a sole trader is not created by any act of registration and as such there are no creation fees payable or continuing annual fees to any government body.

Summary

The type of business structure that is appropriate is frequently not a clear cut decision. It will depend on a combination of the above factors and the particular personal aspirations of those commencing business.

In general terms if the business is substantial or likely to be substantial with significant trade creditors, then the protection which can be obtained from a company structure can result in the limited liability company structure being favoured. However, it is important to evaluate all of the aspects as the structure chosen can affect licensing requirements.

Transport service licences are not transferable and it is therefore important to have continuity of identity between the ownership of the vehicles, the business structure and the licence holder.

This summary is intended only as a guide. It is not a full summary of the law relating to the structuring of businesses.

If you have specific questions, or need legal advice on a particular issue, please contact Cathy Fisher or Shafraz Khan at Fortune Manning Lawyers. Cathy and Shafraz have extensive experience in all areas of the law relating to the transport industry.

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