BUSINESS: OWNERSHIP STRUCTURES

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INTRODUCTION

The information contained in this summary is intended to outline in general terms business ownership structures. Related to our article on Asset/Succession Planning, there are a number of tools available to hold your various assets and operating structures. These include holding assets in partnerships, companies, trusts (or a combination of them), leases, and dealing with those assets through wills, powers of attorney, and various forms of insurance. Each has its own unique characteristics and we comment on the advantages and disadvantages of each.

Please note that your own circumstances may involve aspects which are not expressly mentioned in this guide. Similarly, there may be information contained in the guide, which is not relevant to your own situation. This is a general guide only.

SOLE TRADER

This is the simplest form of business ownership. All income the business earns is derived and taxed in your name.

The advantage is that simple means cheaper accounting fees and what you earn you own. However, there is no flexibility. It is difficult to distribute income to family members. You are personally liable for all debts and liabilities of the business. If you are unable to repay those debts or liabilities you could face bankruptcy (no creditor protection).

PARTNERSHIPS

A partnership arises where two or more people jointly carry on business, intending to make a profit. The partners own the partnership assets jointly. Most partnerships in New Zealand are general partnerships. You do not need to register a partnership under any statute. All that you need to do to form one, is a written, oral, or implied agreement between the partners.

The main advantage of partnerships is their simplicity. The partnership holds and derives income from the partnership assets and each partner shares in those assets and income. However each partner is jointly and severally personally liable for the partnership liabilities. If the partnership dissolves or sells assets, there are a number of tax consequences including depreciation recoveries. Some of these drawbacks may be alleviated by a partnership of companies.

COMPANIES

A company is a separate legal entity and is registered under the Companies Act 1993. Assets are owned by the company and not by the shareholders of the company. The company is controlled by the directors except for major transactions, which must be approved by the shareholders.

The principal advantage of a company is the separation of powers. The company owns the assets and incurs the liabilities. If the company should suffer financial distress then it is the company that is liquidated not the shareholders. The shareholders liability is limited to their paid up shares. They are not personally liable for the company's debts.

This separation of powers also assists from a taxation point of view. The shares in the company may be transferred without affecting the underlying assets owned by the company e.g. there will not be any depreciation recoveries on the transfer of the shares. The major disadvantages include the extra compliance costs and the inability to pass on losses to the shareholders. However, if it is foreseeable that the company will make losses then it can become a Loss Attributing Qualifying Company (LAQC) allowing any losses to be passed through to the shareholders.

TRUSTS

A trust arises when a person (called a trustee) holds assets on behalf of another person or group (called beneficiaries). The trustee may be an individual, individuals, or a company or a combination of them. The beneficiaries may also include the trustee. The most common form of family trust in New Zealand is a discretionary trust. It is discretionary because the trustee has the right to decide which of the beneficiaries will receive the income and capital from the trust's assets.

Because of the trustee's ability to allocate income to a discretionary beneficiary, you can imagine the flexibility this allows distributing income between beneficiaries. Usually the trust deed also allows the trustees to capitalise income in the trust 6 months after the financial year ends. Both of these tools are beneficial from a tax planning point of view. However the major disadvantages of trusts are their inability to pass on tax losses to beneficiaries and the personal liability of trustees.

COMPANY – TRUST STRUCTURE

When you add the combination of a company and trust together, you have a very flexible tool to control and distribute wealth from your income earning assets.

From an asset protection point of view, a company may manage your operations. This gives you the protection of limited liability from creditors. If the trust owns the assets, then they are better protected from potential claims of creditors against you personally.

From a tax point of view, the company has the ability to both pay a salary to you up to your maximum marginal tax rates (this will depend on IRD rules of salaried shareholders), and pay the balance as a dividend through to the trust. The trustees can then decide whether to pass on the dividend to the beneficiaries or retain it in the trust. In this situation the trustees can pass on the company dividend imputation credits to the beneficiaries or the trust may pay tax at the same marginal rate as the company.

EQUITY PARTNERSHIPS

These are usually used when more than one party wishes to carry out a business venture or scheme in partnership.

The parties may have equal sharing in the venture or one party may be providing the capital and the other the day to day management of the operations but no capital. This is commonly used in the farming arena to encourage more persons on to the land without putting in a lot of money.

Usually it is structured as a company having various levels of ownership.

Usually the parties will enter into a shareholders' agreement that will detail what each party's roles are within the venture, their remuneration, and policy on dividends etc.

LEASES/LICENCES

Leases allow the owner of an asset to grant to another the right to use the asset in return for rent. Any type of physical asset such as land, stock, or plant can be leased. Licences operate in a similar vein and can be used for intellectual property such as trade marks and patents.

Leases or licences are a useful device to separate the ownership of an asset (which can be significant and may require protection) from its use. Care needs to be taken though in structuring the lease as there are tax consequences where a lease may be characterised as a finance lease or an operating lease.

WILLS AND POWERS OF ATTORNEY

A will is a document which details what is to happen to your assets upon your death. A will has special requirements and should therefore be prepared by Currie Lawyers. If a person dies without leaving a valid will their assets pass to various relatives in accordance with the Administration Act. This may be unsuitable for the surviving partner therefore it is important to have a will. For further information on wills please obtain a copy of our article on wills.

A power of attorney is a document authorising another person to deal with your assets or make decisions about your welfare on your behalf. In New Zealand you can grant enduring powers of attorney. This allows the attorney to manage your assets and your welfare even if you become incapable of doing this yourself.