

## INDEX

<b>GETTING STARTED</b>	<b>2</b>
<b>HOW TO STRUCTURE THE BUSINESS</b>	<b>3</b>
<b>APPLYING FOR A LOAN</b>	<b>6</b>
<b>BUYING AN EXISTING BUSINESS</b>	<b>7</b>
<b>THE PROCESS</b>	<b>8</b>
<b>SETTING UP A NEW BUSINESS</b>	<b>10</b>
<b>SUMMARY</b>	<b>12</b>

## GETTING STARTED

A Business Plan is essential to set your course and to obtain finance. We invite you to write yourself answers to these questions.

- Why do I want to go into business?
- What do I hope to achieve?
- What are my specific objectives in starting this business?
- What are my strengths and assets?
- What obstacles do I face?
- What is the business environment in which I will be competing?

You will find you have established your ideas, and formulated reasons that may have been hazy before. That is the key to knowing where you are going, and how you are going to achieve your plan.

The formula for a successful business plan will take into account both you, your strengths and weaknesses, and your business environment. To attract customers, you need to understand the competition and how the business environment works in your particular area. This will include taking a careful look at the particular location you have in mind both in a commercial sense and in relation to zoning requirements. And do not forget to include in your step-by-step planning all the various permits and registration necessary for your business. Your lawyer may prove a good resource to get your business moving.

## HOW TO STRUCTURE THE BUSINESS

Will you go it alone? Into Partnership? Will you set up a Company or a Trust as the shape of your venture?

Other important considerations include:

- The need for the flexibility of business structure at the outset.
- An ability to grow and introduce additional players.
- The exit of existing shareholders during the life of the company.
- The movement of cash and capital to owners.

Your options include:

### SOLE PROPRIETOR

A sole proprietor can trade under a personal name or under a registered business name. There are a number of advantages to this type of business:

- It is relatively easy and inexpensive to establish
- It means the proprietor has total control
- It does not require the filing of a separate taxation return

There are also a number of disadvantages:

- It requires a significant personal commitment (which may of course be the case for other options)
- It may give the business a limited life since it is tied to the life of the proprietor

- It may mean limited access to finance
- It carries the threat of personal liability for business debt or loss

### PARTNERSHIP

When two or more people pool their resources and form a partnership a business name may need to be registered. It's important that the rights and duties of each partner are set out in an agreement. This should be in writing and professionally drawn up. A lawyer can advise you on what should be included in such an agreement.

If there is no partnership agreement, or where there are matters that are not covered in that agreement, the Partnership Act is the relevant legal guide. If no deed is prepared and signed at the outset this could create difficulties should problems or disputes arise in the future.

A few points to note are:

- A partnership is not a separate legal entity. It cannot grant a registered charge or mortgage over partnership assets and it is therefore more difficult in some cases to raise debt. Individual partners can grant charges over personal assets, which will be registered under the Personal Properties Securities Act, but such charges should be restricted to those assets in the business. Personal debt should be kept to the lowest extent possible.
- Partners are still personally liable for the business' debts or losses
- Partners are presumed jointly liable for contracts made by any other partner so knowledge of your co-partners' actions is important, as is mutual honesty and trust existing between partners.

## **COMPANY**

A Company is a more expensive structure than a partnership, both to establish and to operate. It does, however, have a distinct identity separating it from the people who own it.

A Company can own property in its name. It also has the right to sue (and be sued) as a separate entity. Operating under a Company structure may have tax advantages, such as a lower tax rate of 30%, as opposed to the higher personal rate imposed on a partnership or sole trader. If the Company elects to be a Loss Attributing Qualifying Company under the Income Tax Act, this enables losses to be absorbed by the shareholders where the company has five or fewer shareholders.

In the absence of personal guarantees, the liabilities of Company members are limited. However, Company Directors have many statutory obligations as well as duties and responsibilities. They must act honestly and in good faith for the benefit of the Shareholders of the Company. They must exercise care, skill and diligence in performing their duties. A Company Director can be fined, sued by Shareholders or prosecuted if these obligations are not met.

## **TRUST**

The law concerning Trusts is complex. An inadequately drafted Trust Deed, or a failure to appreciate the problems that may arise, can lead to serious complications, so it is important to rely on the skill of professionals in establishing a Trust to run a business.

The main type of Trust used to run small businesses is a Discretionary Trading Trust.

In the Discretionary Trading (or Family) Trust, the Trustee has a wide discretionary power in relation to distributing income and assets amongst the named beneficiaries. The Trustee can be a Company or a person. A Company Trustee will add an extra layer of complexity, but does offer more flexibility and has the advantage

of limited liability. Independent trustees should also have their liability limited to the assets of the Trust at any given time.

This is a popular form of business structure because it is flexible and it provides tax saving by spreading income amongst family members. There will usually be clauses in the Trust Deed which give the Settlor of the Trust the power to appoint and remove Trustees. The trust also gives a degree of anonymity as the beneficiaries' identities need not be disclosed in any business transactions.

Distribution of capital under a Trust is discretionary and not received as of right by all beneficiaries. For tax purposes, the Trust is currently taxed at 33%, but could attract higher tax rates on the residual income of the beneficiaries.

Some specific questions about setting up a new business are answered later in this Guide.

## **APPLYING FOR A LOAN**

The first step is to determine if you have security (usually property) available to support the loan. If so, provide a copy of the Certificate of Title and/or rates certificate to the lender. Then provide financial statements and/or personal income tax statements for the past three years.

Significant assets may also be used as security for borrowing in which case valuations need to be provided to the lender.

Next, arrange a meeting with the lender to discuss all the relevant details. This is your chance to determine which structure best suits your requirements and also to obtain information about loan rates and fees.

When you fill out the application form you will be required to complete an Asset and Liability Statement which details your current asset position and any existing debts. It is helpful to supply

supporting information about any existing loans such as the terms and the repayments.

As well as this historical information, you may need to supply additional financial information in support of your loan application. For example, you could provide a cash flow budget for the next one or two years. This will show that you have planned ahead and have a careful management strategy.

You should also provide the lender with a copy of the Contract of Sale where this is appropriate and a copy of the title for the property to be taken as security. If you have a recent valuation report, attach that to your application too.

## **BUYING AN EXISTING BUSINESS**

To complete an adequate Agreement for Sale and Purchase for an existing business, the following matters need resolution:

### **THE PARTIES NEED TO AGREE TO**

- The purchase price
- The division of the purchase price into separate values for goodwill, plant and equipment and stock
- The vendor's ability to vary the stock figure pending takeover
- The vendor's obligation to stay on after takeover to show the purchaser how to operate the business.
- The amount the vendor warrants the business has turned over for a guaranteed period usually being the last 52 weeks.
- The period for and territory in which the vendor promises not to trade in opposition with the purchaser.
- GST issues

When buying a business, a due diligence process should be entered into and this assessment should include the following:

- Consideration of current lease and major contractual arrangements
- The valuation of company assets
- Details regarding employee entitlements, current disputes and health and safety matters.
- Any potential tax exposure or liability such as the depreciation or increase in market value of assets, and any outstanding tax bills that need to be paid.
- Cash flow and accounts of the business dating back a reasonable period.

## **THE PROCESS**

Realty agents are often involved in the formulation of the business agreement for sale and purchase. There exists a pre-printed Law Society approved form which is completed by the agent. The respective parties attend on their Solicitors to complete the finer details. Tax issues hold key implications. Both parties usually covenant to be GST registered at the time of supply and this enables the purchaser to obtain from the vendor a zero rated invoice to avoid the need to pay GST on the purchase price. Another tax implication involves the amount of depreciation recovered which the vendor may have to pay. This arises if the plant figure is under or over valued when compared to the value of the plant and fixtures in the vendor's annual accounts. As a result, tax liability could arise if a market valuation is higher than the book value of such assets.

## DOCUMENTS

It would be prudent for a purchaser, at an early stage, to look at the vendor's last three years annual trading accounts together with all leases and other commercial contract documentation. This might include franchise agreements which the vendor needs to pass on to the purchaser.

The purchasers may also want to look at all resource consents held and applied for by the business, descriptions of hazardous substances involved in the company's operations and a list of the licences or permits required to operate it.

## FINANCE

If finance is required Bankers require sound financials to be submitted together with a business plan. We can provide you with a draft business plan to assist you with your requirements.

## USUAL CONDITIONS

Most business agreements are subject to the purchaser raising finance and the landlord agreeing to assign any lease in respect of the business premises to the purchaser.

In most instances the vendor is obliged to pay all holiday pay and other payments due to any employee up to the date of takeover. Many agreements provide for the vendor to terminate the employment of former workers with the purchaser having the option of taking on those workers to continue assisting the purchaser to run the business. Employment contracts are part of modern life and the purchaser intending to take over any former employees should examine the earlier employment contract and arrange up to date new employment contracts for the new term of employment.

## SETTING UP A NEW BUSINESS

Setting up a new business is an interesting but time consuming process.

## STRUCTURES FOR NEW BUSINESS

As stated earlier, the structure of a business may range from sole proprietorship, partnerships, joint ventures, Discretionary Trusts, and Companies. The tax considerations of each structure are important for the future of the organisation. Two further structures to be kept in mind are the Qualifying Company and the Loss Attributing Qualifying Company (LAQC), both creatures of tax legislation. In the context of family businesses, an LAQC will almost always be preferable to an ordinary Company. When a new or restructured business arrangement is being contemplated, questions which should be asked include:

- What are the legal, accounting and tax compliance costs in setting up the structure?
- How will transactions between this entity and the owner or related parties be taxed?
- Does the structure give rise to any tax planning opportunities such as income splitting or streaming?
- Will capital gains or profits or losses become trapped in this entity?
- If assets are to be transferred to the business, will the transfer crystallise any tax liability, e.g. depreciation recovery, trading stock adjustments or taxable capital gains?
- Do any tax issues arise upon the admission of new investors or participants?
- Are assets such as imputation credits or tax losses likely to be lost on change of ownership?

- What tax costs are involved on the eventual sale, wind up or liquidation of the scheme?
- Is there a risk of either specific or general anti-avoidance provisions applying?

Of course the choice of business structure is not motivated solely by tax considerations. Some other wider commercial considerations include:

- The type of structure that best suits the business to be carried on.
- The cost of formation
- The availability of capital at both initial and subsequent stages
- Whether the source of capital can be drawn upon for both working capital and any additional capital on expansion
- The degree of control afforded to owners
- Whether the vehicle provides for limited liability
- Whether minors can become members
- Procedures on winding up

## SUMMARY

Most people setting up small businesses need professional advice on how to structure their business. They experience the negotiation phase of buying and selling a business. Often they are involved with real estate sales and purchases together with leasing and licences. Intellectual property matters arise such as franchise agreements, copyright, trade marks and other important matters such as protection of business names and confidentiality. Employment law issues arise along with the need to organise finance and marketing plans. A sound business plan and not starting a business without sufficient capital are key factors in the success of any business.

The team at Govett Quilliam is well experienced in advising the buyers and sellers of existing businesses and assisting entrepreneurs setting up new businesses. Please feel free to call us for more detail about the general matters set out in this guide.

Please call this office if you would like further information on any guide prepared by this firm. Copies are also available from our website.

- *Asset Protection and Residential Care Subsidies*
- *Business Grants & Assistance*
- *Buying or Setting up a Small Business*
- *Charities*
- *Companies Act 1993*
- *Consumer Guarantees Act*
- *Credit (Repossession) Act 1997*
- *De Facto Property Rights*
- *Employment Law*
- *Enduring Powers of Attorney*
- *Fair Trading Act 1993*
- *Family Trust*
- *Flexible Working Arrangements*
- *Franchising*
- *Health & Safety in Employment*
- *House Buyers and Sellers Guide*
- *Immigration*
- *Insolvency and Bankruptcy*
- *Intellectual Property and Copyright*
- *Securing Money Lent*
- *Subdivisions*
- *Traffic Offences and Breath Testing Procedures*
- *Wills & Estate Administration*

Govett Quilliam  
THE LAWYERS

All information in this guide is the best of our knowledge true and accurate. No liability is assumed by Govett Quilliam or its partners, or publishers, for any losses suffered by any person relying directly or indirectly upon this guide. It is recommended that clients should consult a representative of the firm before acting upon the information contained herein.