TRADIE LAW FACT SHEET

PROTECTING YOU AND YOUR BUSINESS

Business Structures – Sole Trader, Company or Partnership – Which is right for you?

OVERVIEW

You've got a great idea for a business and want to get started on developing it. But you've heard there are different kinds of business structures and don't know what's right for you. You're not alone and have come to the right place.

In New Zealand, there's a huge number of businesses, most of them small to medium enterprises (**SMEs**). Most New Zealand businesses fall into three different structures – sole trader, partnership and company.

To help you get an understanding of these three structures and identify which one might be best for your new business, here are the key benefits and considerations for each structure.

Sole Trader

The simplest form of business structure in New Zealand is a sole trader. This is where an individual operates a business personally, either in their own name or under a trading name. For example, a plumber, Jim Smith, operates a business himself, using the trading name "Mr Fix It".

Under this structure, the individual trader is legally responsible for all aspects of the business. You will make all decisions in relation to the business, and you will also be responsible for the consequences of those decisions.

Sole traders can hire other people to help with their workload. So Jim can hire Emily, an apprentice, to help him on the job. He can also hire Adam to help with the business accounts and records.

Highlights

- You are responsible for all decisions and are personally liable for all debts of the business;
- You can use your own personal IRD number;
- You need to pay yourself, usually as distributions of business profits;
- Generally, losses incurred by the business may be offset against your other income;
- You must pay your own KiwiSaver contributions.

Positives	***Negatives***
Very simple and inexpensive. Little ongoing compliance costs or paperwork	Since there is no separate entity to enter contracts, you are personally responsible for all debts or liabilities of the business. You can be sued personally and your personal assets are at risk of claims by creditors.
You can use your own name or a trading name and you don't need to register that	Your ability to complete work and grow is largely dependent on your own personal

name (but should use it consistently)	efforts. If you get sick or need to take time off, you won't earn any income unless you have an employee or contractor who can keep working.
You have complete control of the business	It may be difficult to arrange bank finance, since the business is largely built around one person.
Ability to offset business losses against other income	

Partnership

Partnerships are a more formal business structure than a sole trader. It is where two or more people join together to form a business, known as a "firm", for the purposes of running the business.

The key with partnerships is that everything is joint – decisions must be made jointly, funding is contributed jointly, all the partners must apply their efforts for the benefit of the partnership, and all of the profits and debts of the partnership are shared among the partners.

For example, Jim, Emily and Adam all join together to form a partnership, known as "Fix It Plumbing". Each of Jim, Emily and Adam become partners in the firm, rather than Emily and Adam being employed by Jim.

Highlights

- Must have a formal written Partnership Deed which sets out the details of the relationship between the partners, under the Partnership Law Act 2019;
- Partnership has its own IRD number;
- Has between 2-20 partners;
- Each partner pays tax on the share of net partnership income they receive;
- Generally, partners can offset their share of business losses against other income;
- Each partner is responsible for their own KiwiSsaver contributions;
- Each partner is jointly and severally liable for debts incurred by the other partners, even if they are incurred without knowledge/agreement.

Positives	***Negatives***
Fairly simple and inexpensive to run. Flexibility can be built into Partnership Deed, so that partners have different ownership percentages and rights.	Requires a formal written Partnership Deed.
Responsibility is shared among partners, which takes some of the load off you as an individual	Partners are jointly and severally liable for the business' liabilities and debts incurred by other partners even if they did not know about them. This applies regardless of how much of the partnership you own.
Little ongoing paperwork or compliance	It can be complicated when a partner wants to leave the partnership
The partnership can trade under any name it wants, and does not need to register that name (but should use it consistently)	As more people are involved in decision making, there can be disagreements between partners, which leads to conflict
Finance may be easier to obtain, as at least two people's resources are being pooled together	

Company

A separate legal entity that exists on its own, like a natural person. The company is made up of shares, which are held by its owners. Day-to-day management of the company is the responsibility of the company's directors, who may or may not be shareholders too. However, some decisions are so important that shareholder approval may also be required.

The company can sue and be sued, enter into contracts and buy and sell property in its own name. Unlike sole traders and partnerships, which are not separate legal entities, companies exist separately from their directors and shareholders.

The main benefit of the company structure is limited liability. That is, since the company itself enters into contracts, the company alone is responsible for the obligations created under that contract. Generally, directors and shareholders are not personally at risk of liability from the affairs of the company.

However, in most situations banks and suppliers will require personal guarantees from the company's directors and shareholders (to avoid the risk of the company failing and being out of pocket). Therefore, for many small to medium enterprises the risk of personal liability remains.

In our example, Jim, Emily and Adam set up a company called "Fix It Plumbing Limited", with each of them acting as directors and 33% shareholders.

Highlights

- Separate legal entity, distinct from its shareholders and directors;
- Money earned and assets owned by the company belong to the company, not its shareholders or directors;
- Generally, the company pays its own income tax based on the company income tax rate of 28% (but there are some exceptions);
- Payments are made to shareholders by way of dividends from company profits;
- Directors are responsible for day-to-day decision making, while shareholders own the company (but not its property).

Positives	***Negatives***
Opportunity for personal asset protection, provided by limited liability. Business debts and liabilities will not fall on directors or shareholders in most situations, although personal guarantees will likely be required (especially by banks).	Formal business structure, requiring incorporation with the Companies Office and payment of fees on ongoing basis
Flexibility in ownership structure (i.e. different shareholdings)	More complex to start and run, with higher ongoing compliance costs
Shares can be bought and sold relatively easily. Therefore, it is relatively easy to bring in new shareholders or have shareholders exit (the company continues on regardless, unlike partnerships and sole traders).	Owners not necessarily involved in day-to-day decision making (which can be good or bad)

Further reading on different business structures can be found at the Business NZ website here https://www.business.govt.nz/getting-started/choosing-the-right-business-structure/business-structure-overview/

If you require advice around how best to structure your business, get in touch so we can help.

Contact:

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One of our team will be in touch to assist you within 24 hours.