Stephen Larsen and Co
TAX AND BUSINESS ACCOUNTANTS

Guide: Companies

What is a Company?

A company is a legal entity that is separate from the people who own it (the shareholders). Every company is registered at the New Zealand Companies Office. This is a business unit within the Ministry of Economic Development.

Certain information regarding such things as ownership of a company is available to the public.

This can be accessed at the Companies Office website.

All companies are governed by the Companies Act 1993.

Company directors have many statutory obligations and various common law duties and responsibilities under the Act.

Types of company

For tax purposes, three types of company structures exist for small/medium-sized businesses. These are:

- Standard Company
- Look-Through Company (LTC)
- Qualifying Company (QC) (now replaced by LTCs but QCs formed generally before 1 April 2011 can still exist)

A standard company is taxed separately from its owners at the corporate rate of 28%. An LTC may be a popular entity for certain small enterprises because losses can flow through to a shareholder. Profits are then taxed at the shareholder’s marginal rate not the corporate rate.

Directors

Every company must have at least one director. Directors are the face of the company. They act on the company’s behalf.

Company directors have many statutory obligations and various common law duties and responsibilities under the Companies Act 1993.

The directors of a company must act honestly and in good faith for the benefit of all the shareholders. They must exercise care, diligence, and skill in performing their duties. if a company director breaches these statutory duties, he or she can be fined and/or sued by a shareholder.

Shareholders

Shareholders are essentially the owners of the company. Each company issues a certain number of shares. These are bought by shareholders.

Shares can be owned by an individual, jointly in partnership, by a family trust or by another company. Shares can be bought and sold easily. for companies listed on the stock exchange, this is best done through a share broker. for private companies, a share transfer form is completed detailing the transaction. This is retained by the company and notified to the Companies Office on an annual basis.

Advantages of being a company

While there are different types of companies, the advantages of company status generally include:

- Limitation of liability
- Some tax advantages
- Ability to change ownership through trading of shares

Disadvantages of being a company

Disadvantages include:

- Slightly more expensive to set up and run
- Separate tax and company returns required
- Stricter annual requirements, for example, to prepare minutes, file an annual companies return etc
- Higher establishment costs
- It can be a lengthy process to dissolve a company
- Directors must understand and carry out their responsibilities

Liability

In general, shareholders of a company are only liable for the company's debts to the amount outstanding on their shares.

In general, company directors are only liable for the company's debts to the amount outstanding on their shares, or to the amount of any personal guarantee given by them. They can, however, be personally liable for the debts of a company, if the company continues to trade while it is insolvent or if the directors have traded recklessly.

Often, in the case of smaller companies, shareholders will be asked to provide a personal guarantee to people or entities that are lending money to the company. This could be a bank, financier or supplier that is selling goods on credit to the company.

The bank, financier or supplier may not feel comfortable having only any unpaid share capital as the amount they are able to seek from shareholders in the unfortunate event that a company cannot pay its bills. They therefore request that the shareholders guarantee the debts of company.

Shareholders should consider the implications of signing personal guarantees carefully. By signing personal guarantees, if the company cannot pay its debts the personal assets of shareholders can be called upon to meet the company's debts.

Taxation

A company is taxed at the corporate rate of 28%.

Often what happens in smaller closely held companies, is that once the annual profit for a company has been calculated, a decision is made as to how much of that profit should be credited to the shareholders of the company. This is done to remunerate them for the work they have done on behalf of the company.

Where dividends are paid to shareholders in most instances resident withholding tax (RWT) must be deducted from the dividend and paid to Inland Revenue. The rate of RWT will depend on the specific circumstances and the amount of imputation credits attached.

Inland Revenue charges companies "use of money interest" on any shortfall in taxation payments. This is at a rate that is usually significantly higher than the rate charged by the company's bankers. It is therefore important that any company that anticipates having tax to pay in the company's name, makes an early estimate of the amount payable and considers making a voluntary payment of tax. This will minimise the interest charge.

Look Through Company (LTC)

Certain types of companies can apply to Inland Revenue to become an LTC. Generally, these are smaller, closely held companies.

The LTC rules provide for a transparent form of tax treatment for companies. This is to ensure that income and expenses are shared according to each owner's effective interest in the LTC.

For income tax purposes, an LTC's income, expenses, tax credits, gains and losses are passed onto its owners, similar to the income tax treatment for partners in a partnership.

The owners of an LTC are taxed on the profit of the company, as well as being able to offset losses from the LTC against their other income. The owners are taxed at their marginal rate of tax.

Shareholders become personally liable to pay any income tax owing by the company.

Qualifying Company (QC)

QCs are no longer able to be formed. However, subject to shareholder continuity being maintained, QCs formed before 1 April 2011 can still exist.

QCs are companies governed by tax provisions that allow them to attribute profits to their shareholders.

Rules allowing certain QCs to attribute losses have been repealed (effectively being replaced by the LTC regime).

Company Formation

There are various methods to form a company. Contact your accountant or solicitor as they are experienced in company formation. There are organisations that can help you form a company or sell you a shelf company.

It is possible to form a company online on the Companies Office website.

Dissolution of Companies

Once a company has ceased all operations it should be wound up. There is a formal process that must be followed. Contact your accountant or solicitor for further information.

Last reviewed on 15 April 2021