



**Hayman Lawyers**

Your lawyers for all reasons

# Company Incorporation

## Corporate entity

The basic feature of a limited liability company is that it has a separate legal existence from its shareholders. The liability of shareholders to persons contracting with the company is limited to the shareholding of the former. You should take care to ensure all company contracts are clearly entered into on behalf of the company or in the company name to ensure you obtain the benefit of the company's limited liability. Every written communication sent by or on behalf of the company must clearly state the name of the company including the word "Limited".

The other advantages of a company structure are:

- the ability to separate management from ownership;
- the ability to issue different classes of shares to provide different rights and benefits to shareholders;
- the ability to allow expansion by issuing more shares in the company to investors.

Any contract entered by the company, or on its behalf, before incorporation must be ratified by resolution of the board of directors so that the company formally adopts the contract and therefore the liability and benefits under it. If it is not ratified, the individuals who signed are personally liable and may be sued if the contract is breached.

## Obligations of companies

Any change in the registered office or address for service must be given to the Registrar at least 5 working days before the change.

A company must keep at its registered office:

- The constitution of the company (if it has one).
- Full and accurate minutes of all meetings and resolutions of shareholders for the last 10 years. Although not so significant with only one shareholder, this will become more significant when the number of shareholders is greater than one.
- An interests register disclosing any director's personal interest in a contract entered into by the company.
- Full and accurate minutes of all meetings and resolutions of directors within the last 10 accounting years.
- Certificates given by directors under the Companies Act 1993 ("the Act") within the last 10 accounting years.
- The full names and addresses of the current directors.
- Copies of all written communications to all shareholders or all holders of the same class of shares during the last 10 accounting years, including annual reports made under section 208 of the Act.

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- The accounting records required by section 194 of the Act for the current accounting period and for the last 10 accounting periods of the company.
- Copies of all financial statements required to be completed by the Act or the Financial Reporting Act 1993 for the last 10 accounting periods of the company.
- The share register.

## Accounting records

The company must keep accounting records that correctly record and explain the financial transactions of the company, enable the financial position of the company to be determined with reasonable accuracy and enable the financial statements of the company to be readily and properly audited (if required).

The company must, within 5 months after its balance date (though most small companies can resolve to take 9 months), prepare annual financial statements, which must be signed by two directors (but where there is only one director, by that director), and include the auditor's report if required. Normally the shareholders of small or closely held companies will unanimously resolve each year that the company's accounts need not be audited. The first annual accounts must be prepared by 31 August in the calendar year after that in which the company is incorporated. If over 25% of the company's shares are controlled by non-New Zealand residents or overseas companies, the accounts must be registered in the Companies Office.

## Annual obligations

The company must lodge an annual return with the Registrar each year together with the prescribed fee.

The company must hold an annual general meeting in each calendar year.

The requirement for an annual general meeting in each calendar year may be fulfilled by a written resolution covering all matters to be dealt with at the meeting and signed by not less than 75% of shareholders.

The company may wish to instruct an accountant to attend to some of the formalities and record keeping. It is important to record who is to attend to which items.

## Share register

The company is obliged to maintain a share register that records the shares issued by the company and states, amongst other things:

- the names and the latest known addresses of all persons who are or have been shareholders;
- numbers of shares and classes of shares held by each shareholder;
- dates of all dealings in shares (including their issue, and transfer); and
- whether there are any restrictions or limitations on share transfers.

If the company wishes to issue further shares, the directors must carefully follow the procedures set out in the Act and the company's constitution, if it has one.

## Directors

The Act gives directors the power to manage the company. However, major transactions by the company must be approved by a special resolution of shareholders. A major transaction is one which involves acquiring or disposing of assets worth the whole or the greater part of the assets of the company. It also includes taking on obligations, or acquiring rights, of that value.

The definition of a director is broad, and varies with the context. People who have not been elected or appointed as directors may be caught by the definition and therefore have responsibilities under the Act. Those who control directors, and people to whom directors delegate tasks, may be caught by the definition.

The duties of directors to their company include:

- To act in good faith in the best interests of the company;
- To exercise powers for a proper purpose;
- To comply with the Act and the constitution, if any;
- Not to allow the company's business to be carried on in a manner likely to create a substantial risk of serious loss to creditors;
- Not to agree to the company incurring an obligation unless the director believes on reasonable grounds that the company will be able to perform the obligation;
- To exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances.

## Constitution

A company may adopt a constitution if it chooses. The constitution details the rules governing the company's operation. If you don't have a constitution, then the company will simply be governed by the Act.

The advantages of a constitution is so that the company may modify, restrict or extend some of the provisions in the Act. For example, a constitution may be useful to:

- set the minimum and maximum number of directors;
- place restrictions on selling shares to third parties without first offering the shares to existing shareholders (pre-emptive rights);
- allow different classes of shares to be issued (for example, shares that give the holders different entitlements to appoint directors or receive dividends or non voting shares);
- set out procedural rules for the frequency and process of meetings;
- allow directors to be indemnified or insured.
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If the company has a constitution, you should ensure its requirements are followed. We encourage you to familiarise yourself with the constitution because there are penalties for non-compliance. If you have any uncertainty you should get advice from us.

## Solvency

The ability to satisfy the solvency test is crucial to the operation of companies under the Act. The purpose of the test is to ensure directors do not make decisions that result in the company becoming insolvent. For instance, if directors make a distribution (e.g. pay a dividend) when the company cannot satisfy the solvency test, all or part of the distribution may be recovered from shareholders, and directors may have to make up any shortfall personally.

The solvency test is:

- Can the company pay its debts as they fall due in the normal course of business; and
- Is the value of the company's assets greater than the value of its liabilities, including contingent liabilities?
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When calculating the value of a "contingent liability", you may take into account the likelihood of the contingency occurring. The Act describes what financial statements you should refer to when deciding whether the company can satisfy the test. You will probably need our advice while getting used to working with the solvency test.

## Directors certificates

Certificates are often required to record the grounds for a decision of the directors. In the case of a decision requiring that the solvency test is satisfied, the certificate must say that those directors voting in favour of the resolution believe that the company will satisfy the solvency test after the relevant action has been taken and state the grounds for that opinion. The Act requires the opinion to be given on reasonable grounds. Failure to certify, or failure to do so properly, is in some cases an offence. It can also make the directors concerned personally liable for any losses suffered by the company.

Some of the matters that require certification are the decisions to:

- Determine the consideration for the issue of shares;
- Make a distribution to shareholders;
- Acquire the company's own shares;
- Give financial assistance for the purchase of the company's own shares;
- Pay directors' remuneration;
- Provide insurance to directors;
- Amalgamate.

## Interests register

Directors must tell the board if they have an interest in a contract entered into by the company. This must be noted in the "interests register". Penalties for non-disclosure can be quite severe and we recommend that you contact us as early as possible if you suspect a conflict of interest may arise.

We note that when a director personally guarantees the obligations of the company under a security (e.g. a mortgage or general security agreement) the director is not interested in the giving of the security provided the director has no connection with the lender.

Directors' remuneration must be authorised and certified by the board. Remuneration can include the payment of benefits, the making of loans or the giving of guarantees for the director's benefit.

Insurance can be provided by the company for directors, if permitted by the constitution, in respect of certain legal actions. These include criminal proceedings which result in an acquittal.

## Shares

Shares are no longer issued with any par or nominal value. The Act states the rights that attach to an ordinary share. You may, however, issue any kind of share (e.g. preference, non-voting), in any number, unless your constitution imposes limitations.

Title to a share is evidenced by an entry in the share register, rather than by holding a share certificate. However, share certificates must still be issued to shareholders who request them.

## Trade Marks

To obtain protection from competitors the company should investigate whether its name is registrable as a trade mark under the Trade Marks Act 1953. We can provide an estimate of the cost of such registration.

The company may obtain some protection for its name under the Fair Trading Act and the general law of "passing off". For this protection to apply, however, the company must prove that its name is very well known. If the company had only traded for a few months it would need to have advertised very widely.

If you wish us to take any steps to search the trade marks register or to register the company name, please let us know.

## Asset protection

Even if your business is set up through a company, you may often find that the directors and shareholders are not protected from liability if (as is usual) creditors, landlords and business lenders insist on receiving personal guarantees from the directors and/or the shareholders. Liability may also be imposed on directors who breach their duties under the Act. We recommend that all directors and shareholders consider transferring their personal assets (for example, their family home) to a family trust. It may also be appropriate for the family trust to own shares in your company. If this is done, any increase in the value of your business will accrue to the trust, rather than to you personally—a major asset protection advantage.

There are also strategies that can be deployed to protect your business's valuable intellectual property (IP) and any premises you own and operate the business from.

By having your IP and business premises owned by other entities (Companies B and C) and then leased or licensed back to your business (Company A), if Company A fails, its creditors will not have access to the building or the IP.

Please contact us if you would like further information about asset protection measures.