LIMITED LIABILITY COMPANIES

Using a limited liability company to hold the farming business assets and debts is becoming increasingly common.

The setting up of a company creates a separate legal entity which carries out a business activity in its own right. The entity will have its own bank account and runs its business activity through this account. A separate set of financial accounts is prepared for this entity, and it has its own tax return and pays its own taxes.

A company is formed with a constitution, which outlines the rules of the company and specifies what the company can and cannot do; i.e. the individual rules relating to governance and operation of the company.

At least one director must be appointed who is responsible for the business decisions of the company. The company is governed by its directors. While the directors are responsible for the day to day running of the company, they are still accountable to the shareholders. The shareholders must sanction certain transactions before the directors can carry them out.

A company can be set up with any number of shares, with the shareholders being the owners of the company. The company, rather than the individuals concerned, owns the assets and incurs any liability. The operation of a company is governed by the ‘Companies Act 1993’

In family companies, the family generally have drawings from the company transferring a regular amount of money to their personal account for personal spending. This is not a salary, or a wage, and so no PAYE is deducted.

The profit of a company can either be included in the company’s tax return, or allocated to shareholders in the form of a “paper” salary, and then included in the shareholder’s individual tax return. A combination of both often occurs.

A company can borrow in its own name, and so the liability of individual shareholders is less than that of a partnership. However, for small companies, the directors are usually required to give a personal guarantee to any bank borrowings. In general, though, the creditors of a company do not have the right to assets of the directors or shareholders, unless some form of personal guarantee has been given. (individuals behind company decisions may be prosecuted under public liability laws if deemed negligent; i.e. permitting the company to trade while insolvent, acting in a reckless manner, etc.; so not complete protection).

Companies are ideal structures for ownership of large syndicated farms where there are multiple owners. The constitution needs to be carefully drafted to ensure protection for all major and minority shareholders. Representation on the Board of Directors for minority shareholders is essential. This has to be balanced with the need for major shareholders to retain some degree of control to protect their more significant investment.

Most joint venture or syndicated companies have a shareholder’s agreement further regulating the management control and structuring of the company. This more detailed agreement is not a public document, whereas the constitution is registered at the Companies office and is therefore publicly available.

Advantages

* More investors are possible, as shareholders.
* A company can be a more flexible structure for a business particularly if unrelated parties are involved, and if more than two or three people own the business.
* Limited liability structure
* Transfers between shareholders are simple.
* Shareholders can hold different proportions of shares, and ownership of the shares can be altered without having to alter the ownership of the company’s assets.
* Company existence is not dependent on people actually remaining; i.e. continuity with shareholders exiting the company.
* A means for the pooling of resources and management.
* Greater efficiencies and economy of scale.
* On the death of a shareholder, shares pass to heirs and the business continues.
* Shares can be purchased, sold or gifted (some continuity).

Disadvantages

* A set-up cost is necessary to create the company
* Extra statutory requirements are necessary; the keeping of a minute book, filing company documents, and other administrative issues
* Extra legal and accounting costs
* Companies can be expensive and cumbersome to wind up, and at times taxation problems can occur

Exit:

If circumstances of a shareholder change, most companies have the flexibility to allow a shareholder to sell his/her shares without the need for sale of the assets. Other shareholders should have first right of purchase of those shares at a fair value. This allows a person to exit from the company without the need for major restructuring.

If no other shareholders wish to buy, most multiple ownership companies would then permit the withdrawing shareholder to sell the shares to outsiders.

The shareholder’s agreement can contain provisions to ensure that any new shareholder is suitable and is bound by the shareholder’s agreement. This allows for continuity of the business.

Alternatively, if no other shareholders wish to buy the outgoing shareholders shares, the Constitution or shareholders agreement can require the assets to be sold and the company wound up.

Taxation

The company tax rate is a flat 28%. Individual tax rates over $70,000 are 33%, so if business profit exceeds $70,000 per individual, then this amount can be taxed in the company at 28%, equating to a 5% tax saving on incomes over $60,000.

A public company is rarely used except in very large Agribusiness. It is like a private company, but is listed on the stock exchange so that shares can be freely traded. Stock exchange listing has a lot of specific reporting requirements that are greater than those for a private company.