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STARTING A BUSINESS IN 2017: THE PRIVATE COMPANY OPTION

"My best entrepreneurial advice is to start" (Dave Morin, entrepreneur, angel investor, CEO and co-founder of social network Path)

In our last article in the series "Choosing the right legal entity for your business" we looked at the partnership option. Let's move on to the private company option, where your business is owned and operated, not by you as an individual or by a group of individuals, but by a "(Pty) Ltd".

Although CCs (close corporations) still exist, no new ones are registered, so we will not consider them here other than to note that the owners of a CC are "members" not "shareholders").

What is a private company?

Our law treats a private company as a separate legal entity, a "judicial person" with its own "legal personality". It exists in law separately from its managing officials (directors and management employees) and its owners (shareholders). You can have as many shareholders as you want (the old limit of 50 has fallen away).

Your personal assets are separated from your business risks. In fact the whole concept of modern laws recognising separate "corporate entities" traces its roots back to the idea that entrepreneurship would be encouraged when individuals could limit their trading liability to their own investment in the business.

Like sole traders and partnerships, a company can use a separate "trading as" name like "XYZ Enterprises (Pty) Ltd t/a Plucky Plumbers" perhaps. But it's always the actual company that trades, contracts and pays tax.

7 advantages of private companies…..

1. A company has "perpetual succession" – it survives the death/incapacity/insolvency/exit of the directors and shareholders. That carries a host of practical benefits, including making it a possible estate planning tool.

2. Transferring ownership and management is easy – shareholders and directors change but the company lives on.

3. Directors and managers have limited liability. Note however that directors and senior managers can be held personally liable in cases of reckless or fraudulent trading, non-compliance with statutory duties and the like - the "new" Companies Act in particular has imposed a whole new set of duties and risks in this regard. Bear in mind also that that your limited liability falls away to the extent that you sign personal surety for company debts.

4. Shareholders are in general not liable for the company's debts, although they do risk liability for some tax debts e.g. if they control or are regularly involved in the management of the company's financial affairs.

5. It is generally easier to raise funding for a company than it is for a sole tradership or partnership.

6. Similarly, a company is adaptable to both small and large businesses, so if you are starting off small but planning to grow substantially, consider using a company from day one.

7. Tax: Sometimes an advantage ….. see below.

….. and 3 disadvantages

1. Formation: Unlike sole traderships and partnerships, companies require formal registration and compliance with various formalities. Factor the attendant delay and cost into your plans. Using a shelf company can reduce the hassle but make sure you buy it from a reputable business.

2. Costs of administration: Prepare for a higher administrative and regulatory burden than with your other choices. Factor in both the time and financial costs of complying with the host of legal requirements, statutory returns and general red tape associated with companies. Find out up front for example whether you are going to have to pay for a full audit or independent review every year.

3. Tax: Sometimes a disadvantage ….. see below.

The tax angle

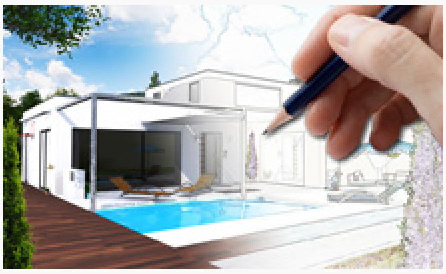
It is impossible to give general advice here; seek specific guidance on what is the most tax-efficient entity or structure of entities for your particular situation. Consider the different tax rates applying to corporate entities for income tax, capital gains tax, transfer duty etc; also the implications of dividend tax, estate duty, exemptions and rebates only available to individuals and so on.

The bottom line is this - take full professional advice on both the legal and the tax implications of using each type of entity before choosing.

This is the fourth article in our series "Choosing the right legal entity for your *business". Next time we'll look in more depth at the business trust option.*

BUYING TO BUILD IN A DEVELOPMENT? READ THIS

"When you're talking about building a house, you're talking about dreams" (Architect Robert Stern)



There are many advantages to buying a vacant plot on which to build your dream house in a property development, but there are also potential risks to be managed. Discuss the pros and cons with your lawyer before you agree to anything.

"Build, or Lose the Plot"

A recent High Court case illustrates one such danger – not building on your plot within whatever time limit is specified. Often developers will impose penalty levies for such failure (the penalties must be reasonable, but will still hurt your pocket) but in this case the defaulting buyer stood to lose the whole property –

- In 2009 a buyer bought a residential plot in a large development for R560,000
- A condition of the sale (recorded in the title deed) was that the buyer had to build a house within 18 months
- If the buyer failed to build by the deadline, the developer could either extend the period or demand retransfer – in which latter event the buyer would get his money back, but without any interest
- Twice, the property was on sold. Both times the sales lacked the developer's permission as was required, but both times the developer regularised the sales by entering into new agreements with the buyers. The final buyer (in 2013) was a trust which had paid R840,000 to the second owner. The trust agreed with the developer to build within 9 months. The agreement was that if the buyer failed to build on time it would transfer the plot back to the developer against payment of the original R560,000 (not the R840,000 it had actually paid)
- The trust failed to build within 9 months and the developer asked the Court to order retransfer of the plot to it. It offered to repay the trust the full R840,000 it had paid to the second owner – a "rather gracious gesture" said the Court since the trust was only actually entitled to R560,000.

The outcome - "Bye-bye plot"

The trust's defences to the developer's claim for retransfer all failed -

1. The Court rejected the trust's argument that the trustee signed the agreement without authority on factual grounds. In any event the trust had from day one been in default of the building requirement
2. Secondly the trust claimed protection under the CPA (Consumer Protection Act)'s unfairness provisions but the Court held that there had been no

contravention –

  - The CPA didn't apply as there was no "transaction" (as defined in the CPA) between the developer and the trust, which had bought from an interim owner not from the developer; and anyway the obligation to build wasn't "goods or services" supplied by the developer to the trust

  - Moreover, the agreement was not "unfair, unreasonable and/or unjust" - the trust wasn't forced to sign, it understood what it was committing to, it was in a position to build, and there was no suggestion that the 9 month building period was unfair

3. Finally, the Court rejected the argument that the agreement violated public policy or was "contra bonos mores" (against good morals), commenting that "in general ….. parties should comply with contractual obligations that had been freely and voluntarily undertaken".

The trust was therefore ordered to retransfer the property to the developer. It loses the plot itself, all capital appreciation in it, and 3 years' interest on its R840,000.

SIGNING SURETY – THE STING'S IN THE TAIL

"She just did not want to be liable if he defaulted, a common regret felt by those who stand surety for defaulting debtors" (extract from judgment below)

In the beginning ….. You are totally relaxed. The bank won't give your son/daughter/spouse/partner/company/friend a loan unless you sign surety and, as always, it seems perfectly safe at the time. So you ask yourself "What's the harm? It's just bank red tape. Johnny's new business will fly. He'll pay back every cent to the bank and I'll have helped him. That's a parent's job isn't it?"

But in the end ….. You get stung. Your signature comes back to haunt you, because our law will generally hold you to what you sign, with very little wriggle room.

A recent High Court case illustrates.

The mother, the son and the suretyship

- A mother signed an unlimited suretyship as "co-principal debtor" for her son's bank debts totaling almost R4.8m from a home loan, an overdraft, and a credit card account.

- After her son's estate was sequestrated the bank sued her for the shortfalls.

- The mother tried everything she could to evade liability. Her main defence was an attack on the validity of the suretyship, and she supported this with a string of claims, often self-contradictory. The bank official had misled her into thinking that she was signing not a suretyship but simply a consent form for an account migration. She hadn't read the document. She had read the heading. Blank spaces in the document were filled in later. It conflicted with an oral agreement. It was limited not unlimited. Her signatures on other documents had been forged.

Let the signer beware – "I signed by mistake" won't cut it

This defence, said the Court, amounted to a mistake on the mother's part in signing the document. That's a defence that our law won't accept unless you can show that your mistake was both material and reasonable. You will have to prove that you had no intention of entering into the contract and that you were misled by a misrepresentation as to the nature of the document, or as to its terms.

Our law strongly presumes that if you sign a document you intend to enter into the transaction it contains, and the principle of "let the signer beware" ("*caveat subscriptor*" to the legal fraternity) makes it difficult to succeed with any form of "I signed by mistake" defence.

On the facts of this case the Court rejected the mother's version of events as false, found that she knew exactly what kind of document she was signing and indeed intended to stand surety, and ordered her to pay the bank in full plus interest and costs on the attorney and client scale.

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Dipping into the dictionary

"Post-truth"*, adj. – "Relating to or denoting circumstances in which objective facts* *are less influential in shaping public opinion than appeals to emotion and personal belief." Chosen by the Oxford Dictionaries as their word of the year following a 2,000% increase in usage following Brexit and the US Presidential election.*

Have a Healthy, Happy

and Successful 2017!

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