

August 29, 2018

Tips on choosing the best legal structure for your business



Starting a new business comes with much ambiguity and responsibility.

There seems to be so many legal requirements when setting up a business that it can be overwhelming.

As much as it is a rather exciting time and one might get carried away, it is also easy to become entangled in and tripped up by a plethora of small ostensibly insignificant permutations which business owners often tend to overlook and do not give adequate consideration in deciding on the most suitable structure for their new business.

Selecting the right business structure from the outset can spare one a lot of headaches later down the line. Each legal structure has diverse pros and cons, and fundamentals such as the nature, size and ownership structure of the new business will all have an influence on this decision. Each of these business structures have different consequences in terms of personal liability, taxes, admin costs, the ability to raise capital, etc.

All South African companies are governed by the Companies Act No 71 of 2008 and also administered by the Companies and Intellectual Properties Commission (CIPC). The new Companies Act 71 of 2008, which was promulgated in 2009 and has been enforced since May 2011, aims to modernise the law and align it with international best practices – especially by aligning it with other South African legislation, such as the Promotion of Access to Information Act (PAIA), etc.

The different business structures and their legal aspects as recognized in South Africa:



Sole Proprietorship

A sole proprietorship is a business structure owned and operated by one individual. It is unincorporated, meaning it is not registered with the CIPC.

It is important to note that with a sole proprietorship there is no separation between the owner and the business structure – the business does not have its own legal entity. In practice this means that all income derived from the business is for the owner's account, as are the taxes and any liabilities. Likewise, the owner is personally liable for the debt and liabilities of the business.



Partnership

A partnership consists of between 2 and 20 individuals who contractually agree to operate a profit-generating business collectively. The partnership agreement or arrangement would determine the split of profits in proportion to their interests in the partnership.

In establishing a partnership, each partner contributes to the partnership undertaking. As in the case of a sole proprietorship, the partnership is not a separate legal entity, leaving partners generally liable for taxes and liabilities of the business.

Sole Proprietorships and Partnerships make sense in business where personal liability is not of concern, for example a small service business in which you are unlikely to be sued and for which you won't be borrowing much money for inventory or other costs.



Private Companies

In South Africa this type of business structure does not place any prohibition on foreign shareholding and only requires a minimum of one shareholder and one director with a maximum of 50 shareholders.

The new Companies Act prohibits a Private Company (Pty) Ltd from offering its securities to the public. Private companies are seen as separate legal entities and as such are taxed in their own right and offer the shareholders protection against liabilities of the company.



Public companies

Public companies are formed to raise funds by offering its securities to the public. There is no limit to the number of shareholders although a minimum of 3 directors is required.

Public companies are known as Limited (Ltd) companies and have their own legal identity.



Personal Liability Companies

If a company incorporates under section 8(2)(c) of the Companies Act, the terms of its memorandum of incorporation (Moi) state that the directors and past directors are jointly and severally liable, together with the company, for any debts and liabilities of the company, as they are or were contracted during their respective periods of office. Typically, this means professionals such as attorneys and accountants make use of section 8(2)(c) of the Companies Act. The companies require the term 'Incorporated' or 'Inc.' to follow the name of the Company.



State-Owned Companies

A state-owned company is either a company defined as a 'state-owned enterprise' in the *Public Finance Management Act 1 of 1999* or a company owned by government. Most of the provisions relating to a public company will also apply to state-owned companies. The name of a state-owned company is followed by the abbreviation 'SOE'.



Non-Profit Companies (NPCs)

A non-profit company is incorporated in terms of the Companies Act for a broader public purpose, for example some form of cultural or social activities or communal / group interests. Income from this type of business structure is not distributed to any director or incorporator but is used to further the objectives of the NPC.

Under the previous *Companies Act of 1973*, these companies were known as Section 21 companies or companies limited with guarantee. Non-profit companies are now dealt with in Schedule 1 to the Companies Act.

The income and property of a non-profit company are to be applied solely for the promotion of the non-profit company's objectives. Non-profit companies are generally not taxed on income related to their objectives due to the benefits they contribute to society. These companies must register separately under Section 30 of the Income Tax Act to receive additional benefits as a Public Benefit Organisation (PBO).



Cooperatives

These are organisations owned and operated democratically by their members, often referred to as a “group”, “collective” or “co-op”. Individuals united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned enterprise engaging in the production or distribution of goods or the provision of services, operated by its members for their mutual benefit and typically organised by consumers or farmers. Such entities are registered under the Co-operatives Act, 14 of 2005.



Closed Corporations

A Close Corporation (CC) is similar to a private company. It is a legal entity with its own legal personality and a taxpayer in its own right. The owners of a CC are the members of the CC. Members have a members' interest in the CC which is always expressed as a percentage. Members are restricted to natural persons or (from 11 January 2006) a trustee of an *inter vivos* trust or testamentary trust.

A CC may not have an interest in another CC. The minimum number of members is one and the maximum number of members is 10. For income tax purposes, a CC is dealt with as if it is a company.

After the implementation of the new Companies Act (Act 71 of 2008) **no new CC can be registered or entities converted to CCs** although all existing CCs may still operate under the Close Corporation Act 69 of 1984.



Trusts

Although it is not advisable to use a trust as a business structure, trusts can also be used to conduct business activities. The objective of the trust should be to allow the trustees to conduct business activities. An operational trust is usually a discretionary trust to allow the trustees to have discretion with regards to the day-to-day operation of the business activities. A trust can only come into existence by transferring property from the founder to the trustees.

The income tax rate for trusts is much higher than for any other business structure mentioned above. Trusts are registered with the Master of the High Court and administered by the Trust Property and Control Act 57 of 1988 and governed by our common law.

SERR Synergy offers a holistic solution that swiftly guides businesses through South Africa's business legislation maze in the direction of greatness. Our range of business solutions include *unique ownership structures, business registrations, shareholder agreements* and providing specialist information to make an informative decision regarding the most appropriate business structure.

About the Author: Sanet van Zyl joined SERR Synergy in June 2014. She is the Trust and Corporate Advisory Manager where she specialises in business solutions and corporate governance.

Additional sources:

<http://www.sars.gov.za/>

©SERR Synergy, www.serr.co.za