

BUYING OR STARTING A BUSINESS - GET IT RIGHT THE FIRST TIME

TV INTERVIEW SCRIPT JULY 2013 – BRENDE LEE – TV9 INTERVIEWING

QCL OWNER MARCUS N BEVERIDGE

1) Introduction

Thanks Brenda.

There are 2 distinct scenarios here really:

- a. Buying a business as a gong concern; and
- b. Starting up a new business on your own

In both instances the answers can be different although some things overlap so we can cover this as we go.

2) What type of structures can be used as a business vehicle?

Rightio - the most common vehicle in NZ is a limited liability company of which there are in excess of 100,000 in New Zealand.

There are also sole traders, partnerships, limited partnerships, trading trusts and differences between closely held private companies, so called "look through" companies and public companies listed on the NZ Stock Exchange.

Brenda: What are the main differences in such structures?

Well Brenda the complete answer to that question could easily take an hour to cover off but to keep things simple because of time constraints:

(i) LIABILITY

There are different liabilities that attach to different business structures. For example, sole traders are personally liable whereas company liability is normally limited to the assets of the company although in extraordinary circumstances tax, employment and health and safety (e.g. Pike River, CTV Building collapse) based liabilities can attach to company Directors and as some recent Court cases have shown the same applies to

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those running Finance Companies (trading while insolvent / reckless trading / fraud or negligence).

(ii) TAX/ACCOUNTING/COMPLIANCE

Different entities have different tax rates and accounting rules. For example, the NZ company tax rate is currently a flat 28% but trading trusts are 33% (although they can split income so it equates to the individual beneficiaries nominal tax rate). Companies which are over 75% overseas owned must be audited every year and there are other tax and accounting consequences such as FBT implications and so on depending on which structure is adopted.

(iii) LIMITED PARTNERSHIPS

Limited Partnerships are relatively new in NZ and are a hybrid between a company and a partnership with a General Partner and a Limited Partner and may be a suitable vehicle for foreign investors working with local partners and in some property development projects.

(iv) BUSINESS SECTOR

Then there are certain business specific sectors which have traditionally adopted certain business models. For example Law Firms and Accountants were traditionally Partnerships (where the owners are usually jointly and severally personally liable). Very small businesses have been sole traders as they are too small to pay for additional compliance costs. Property developers would often use a corporate trustee company on behalf of a trading trust for liability, flexibility and other tax efficient reasons but nowadays because of certain legislative changes plus the reduced company tax rate simple limited liability companies are most common.

(v) FUNDING CONSIDERATIONS

Underlying all of this will be funding factors. In general terms from a credit risk point of view most NZ banks are reluctant to lend money to small closely held companies because if they get into financial trouble there is not much left for the bank in a

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liquidation or receivership scenario so banks will invariably require that the Directors and or Shareholders personally guarantee any loan advances and this will normally be secured by a mortgage over a property as well as a GSA (formerly known as a debenture) over the assets and undertakings of a company.

(vi) **SEPARATE LEGAL ENTITY**

A lot of people however do not properly appreciate that the assets of a company or a trust are NOT yours personally but must be administered in accordance with the company constitution, rules of incorporation or provisions of the trust deed and so on. A company is therefore like a separate human being in this sense.

3) What legal and other issues arise when someone wants to start up or buy a business and what laws and regulations can apply?

Ok - again this is difficult to answer such a question in a limited time but let me try!

- I. First structure e.g. form new company - companies office (quite simple over Internet these days) - as part of that process a constitution is uploaded and people would do well to read it as it governs the companies conduct – more sophisticated business people will tailor make the company constitution perhaps to say reflect a shareholder’s agreement, if a corporate trustee is being utilised or suchlike.
- II. IRD and GST number from Tax Department (IRD) ...note that currently this process is too slow (sometimes taking a month or so !);
- III. Target business - initial and preliminary Due Diligence (DD);
- IV. Decide whether to start own business or buy business as going concern or buy shares in Vendor Company such option having its own unique complexities and further considerations e.g., tax warranties etc) and other structuring based issues;
- V. Discussions / negotiations with business owner or its broker and professional advice from lawyer and accountant;
- VI. Negotiate and agree upon terms of Sale & Purchase of Business Agreement ;
- VII. Formal DD:

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VIII. Settle business acquisition - get on with business.

That is about **PROCESS** which will apply to most business acquisitions and disposals in one form or another.

With reference to your question about the laws and regulations that may apply:

- a. Does deal include land + property? OIO Consent required if non-resident shareholders and if over NZ\$100 M or includes land over 5 H or certain sensitive land - getting it wrong can result in 7 years imprisonment, confiscation of land by government and large fines;
- b. Building Act etc noting substantial seismic and weather tightness issues NZ currently has (calculated to currently be well north of \$50 Billion!!) so madness not to carefully analyse such factors;
- c. LIM + certificate of title searches (confirm dealing with right party etc);
- d. RMA - check Resource Consents - business use = permitted activity;
- e. Lease - what form (quite a few different kinds of leases) Landlord's consent - analyse and obligations - lease terms
- f. Employment issues - new Employment Agreements + Kiwisaver + PAYE + vulnerable staff and redundancy provisions (if any) etc;
- g. Sale & Purchase of Business Agreement - normally Auckland District Law Society (ADLS) version - many terms therein to be negotiated just like when you buy a house - for example Restraint of Trade + Vendor Period of Assistance + breakdown of consideration or purchase price etc;
- h. Fair Trading Act - in NZ if say a Vendor does not disclose a material fact Courts have held that even silence can constitute deceptive and misleading conduct in some cases which very much flies in the face of the old legal doctrine of CAVEAT EMPTOR = let the buyer beware;
- i. Litigation and claims - are there any? Has Vendor disclosed this? Vendor warranties and PGs thereto - is there an agreed mechanism to resolve?;
- j. IP checks;

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- k. Industry specific - e.g. liquor licence - membership of national body - assignment of licences and other requirements.

This list we have just covered is not exhaustive but rather indicative only.

4) Thanks Marcus - Can you give us a better idea of a pre-purchase checklist of what people should do when looking at a business acquisition and the processes and parties involved ?

Sure Brenda - there would normally be several parties involved in the deal:

- 1) The Vendor / seller itself or its business broker (often targeting about 8% of the purchase price of the business); and
- 2) Lawyers and Accountants for the Purchaser and the Vendor; and
- 3) Bank or lender (as required).

There would typically be 8 or so things to work through in a systematic process:

BUSINESS PRE-PURCHASE CHECKLIST

Buying a business is often subject to many surprises and pitfalls. To ensure that you know what you are getting, that you optimise your potential tax benefits and that you are fully informed, we suggest that the following points be addressed:

1) Preparation of Agreement

Identify all parties or nominees;

Identify what is being purchased i.e.: business or company shares (if shares stepping into owners shoes so extra vigilance around matters like tax warranties, law suits, etc);

- Set the purchase price and divisions between stock, goodwill (the tax free component of money in the Vendor's hands), plant, fixtures and fittings;
- Does purchase price include GST? (15% typically sold as going concern so zero rated for GST purposes);

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- Review payment terms and settlement date;
- Insert special conditions e.g., finance, solicitor's approval, approval of the accounts etc.

2) Searches

Obtain all relevant searches including:

- LINZ title search(s)
 - - check ownership of property;
 - - check for any caveats or encumbrances;
 - - check for any registered leases (note unregistered leases may also exist)
- Personal Properties Securities Register
 - check for any General Security Agreements ("GSA's") or charges against the Company and/or the Directors/Shareholders in the Company and/or individuals concerned - need to be satisfied before settlement and often Vendor's lawyer will provide undertaking(s) thereto.
- Motor Vehicles Register- search records for ownership and charges;
- Trade Marks Register
 - obtain indemnities/warranties re ownership;
 - Check for registration of any relevant trademarks and sub-user agreements
- Council /Local Authority
 - We recommend that you obtain a LIM, PIM, Property Bag search;
 - check that existing or proposed business use complies with Council requirements;
 - check for any requisitions on the property;
 - check whether there are any future developments which may affect the property;
 - check re Food Hygiene Regulations licences, if relevant;
 - check re Code Compliance Certificates for any building works or alterations to the building and compliance with Building Consents;
 - check re Warrant of Fitness for building/compliance with Building Code and of course
 - seismic issues – eg obtain an engineer's report.

3) Accounts

- Check profitability of business;
- Check valuation of plant, lease and goodwill;
- Check debtors - age and ability to pay

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- Check monthly turnover and insert appropriate special conditions into ASP - eg deduction in purchase price or retentions etc;

4) Lease

- Check term, rights of renewal, rent reviews and location of original documents;
- Check outgoings;
- Check responsibilities of internal/external maintenance;
- Check carpark allocations and yard maintenance requirements and status;
- Obtain landlord's consent - note for example some leases (eg food court operations) require high level of business experience etc.

5) Equipment

- Check it is in good working order;
- Obtain itemised list with values;
- Check whether any equipment is subject to hire purchase or lease agreements.

6) Stock

- Check that quality and quantity is acceptable and note variation percentages;
- Check suppliers' agreements and terms;
- Check have right to reject obsolete stock etc.

7) Staff

- Check employment agreements or present terms of engagement;
- Check any redundancy/superannuation obligations;
- Check leave payment status.

8) Restraint of Trade

- Ensure that the covenant is adequate to protect you as Purchaser
- Ensure that both vendor and, if vendor is a company, its shareholders/directors sign the restraint;

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NB You don't want the Vendor opening an identical business next door - that's why goodwill is paid and the restraint would often be for a couple of years and a couple of kilometres depending on business type (in some cases can be NZ wide !) and the vendor and the individuals who make up the vendor company needs to expressly agree not to directly OR indirectly compete;
And ensure warranties are obtained from vendor re any impending legal suits and tax.

5 A) What are some other issues to consider for people planning to set up or buy a business

PLAN !!!

An analysis of some of the following factors (which should be on-going) will assist:

What is the proposed business venture, the type of business, industry, position in the market, targeted customers, suppliers and or distributors, required assets and so on.

5 B) Marcus - what sort of things should business people be thinking about and checking when they start up or take over businesses?

Thanks Brenda - Some important fundamental and pretty much daily considerations include:

Location of business + **permitted use** of proposed premises / building - check **zoning** and RMA and check "**business use**" definition in lease.

If possible consider negotiating term in to lease to have **first option to purchase building** or first right of refusal thereto if say landlord decides to sell the property - in such case the purchaser would normally hold the property in a trust or suchlike so they can sell the property and the business separately in the future.

Take a bit of time and get the **lease** or **assignment** right whenever possible - truth is many people do NOT bother and sometimes the results can be TERRIBLE or - simple example is that

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under most leases tenants are required to pay a % of the landlords cost if the lessor is required by say local authority or legislation to improve or rectify the building. After the Christchurch earthquakes the laws are changing as seismic issues become more important but in reality which tenant wants to pay such costs for a building they do not own? A well negotiated lease can indeed pay dividends at the time of sale of the business SO INVEST IN THIS PROCESS AND GET IT RIGHT WHENEVER POSSIBLE!

Health & Safety –

A) Note laws being reviewed currently and likely upshot will be personal liability for Directors for breaches of magnitude of Pike River or CTV building – so best practice required;

B) depending on business type liquor licences and host responsibilities - is training and doing a course required? if professional service or regulated industry registration and consider budgeting for associated costs thereto - is continued education required etc (this is just coming in now for the 11,000 lawyers practicing in NZ for example and already applies to many other industries).

Analyse and understand other **Employment** obligations and get it right from start - ensure Employment Agreements compliant as law changes a lot - minimum wage - maternity leave- holidays act - Kiwisaver - PAYE etc. Introduce new Employment manuals, organisational charts, annual reviews, budgets, bonuses, supervision, staff recruitment and retention and induction programmes - all critical as for many businesses their most important asset will indeed be their staff!

Tax and other **compliance** - audit , GST, PAYE, ACC, Holiday pay, provisional and terminal tax, depreciation analysis - all takes time and continued attention from business owner.

Reputation of business, advertising, **marketing**, market research , new opening specials, competitor analysis, customer satisfaction, customer feedback , terms of trade, introduction of new services , products technology, management skills , overseas business links, quality assurance programs, networking and professional membership groupings etc , business mentoring, customer testimonials, social media +SEO+ website development and ensure ongoing refinement of all .

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Conduct **WOF** reviews and examine creditor protection issues - see link:

<http://queencitylaw.co.nz/wp-content/uploads/2011/12/QCL-WOF-2012-LEGAL-WARRANT-OF-FITNESS.pdf>

This WOF is designed to assist business people **protect** their hard earned assets by appropriate asset planning and structuring; At the simplest level it include for example owning the family home in a trust and ensuring the gifting program is properly done especially as gift duty has now been abolished and the trust is properly administered;

Another linked issue would be insurance cover of directors

Financials, compliance, annual filing and reviews, strategic planning , SWOT analysis , cost of credit funding analysis, review professional advisors relationship and value add , succession planning , grooming business for sale and so on.

5 C) wow - that's a lot of stuff for someone to consider!! And what are some of the intangibles that go into the mix?

That's a very insightful question Brenda and there is no precise one shoe fits all answer but some answers include:

Drive, vision, sweat equity, entrepreneurship, experience, business relations and networks, agility, ability to get up and have another go and of course a little bit of good luck never hurts!!

Sometimes these issues can count as much as all the other textbook stuff, although careful planning and hard work are usually the winners, but that is indeed the inherent nature of business!!

6) I note you have been practising business law for 20 years. Can you give us an idea of some of the work you've done over that period and how your firm operates and so on?

Ok sure.

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My firm **Queen City Law** which I own, has 10 or so lawyers and other support staff that I employ. We specialise mainly in Business Law, Property & Construction, Immigration & Litigation.

In the last several years we have been awarded NZ Boutique Law Firm of the Year 3 times and NZ Property and Construction Law Firm of the Year 4 times. This is due to the very client-centric approach to legal services we adopt.

I employ all the staff and have been very lucky to have some extremely talented and capable lawyers and other staff working for me and we have nurtured a great team culture.

We are tied to Asia to some degree - my lawyers speak Indonesian, Cantonese, Mandarin, Korean, Tagalog and Spanish...and a bit of English!

Personally I have represented a couple of international airlines, major property developers, some funders, golf course owners, recruitment companies, nightclub owners, real estate companies, manufacturers and literally hundreds of other business owners with assorted wide ranging business pursuits over 20 years with all of their legal requirements.

Also, our focus is to become trusted partner advisers and whenever possible we try and add value as part of our delivery of legal services.

I also think we have acted in more successful business and millionaire immigration cases than anyone else in NZ since 1999 and some of these immigrants have subsequently become excellent long term clients.

7) Can you please provide some quick comments on Long Term Business Visas?

Yes - I think we have processed more successful LTBVs than anyone else in the country since 1999.

Currently there are 1500 or so cases under application with the Business Migration Branch in Wellington and the majority are Chinese and they also have the highest decline rate by a long shot.

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Essentially an applicant must have relevant business experience, reasonable English (level 4 IELTS), sufficient money to buy or set up the business and also to be able to live in NZ for 3 years and be of good character and health.

Production of a 20-30 page tailor made business plan is required as well as 3 year financial forecasts.

At the moment these regulations are silent on the quantum of money required to be invested but this is being reviewed by Government albeit slowly, although we are advised that changes may come in next March (2014) but we are not holding our breath. There are also initiatives afoot to marry Chinese capital to kiwi undercapitalised entrepreneurs but this is always easier said than done.

After successfully running the business for 2 years in NZ with the emphasis all on significant BENEFIT to NZ's economic development an applicant can then apply for a residence visa under the Entrepreneur Category.

We love this category as it fits our skill set perfectly and we are able to provide a one stop shop to clients and deal with their subsequent legal and compliance issues over the 24 month period.

8) Marcus - we've covered quite a lot of ground today - in there anywhere people can go to study in further detail what we have covered ?

Brenda - yes!

We have spent a lot of time over the years developing material for our website for this very purpose and I think we have one of the most helpful legal websites on the planet.

Our underlying philosophy is that the better informed the client is the less time and money involved from both parties point of view and the better the outcomes for our clients.

So I reckon a couple of hours on our web is a seriously good investment for business people and entrepreneurs both experienced and just setting out.

The website is www.queencitylaw.co.nz

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There is an on-line library covering many practical legal issues (under Queen City Law Library).

Heading).

Checklists include:

Buying a business

Grooming a business for sale

Restraint of Trade issues

Redundancy checklists

Distribution Agreement checklists

Lease checklists

Rent Review checklists

Personal Warrant of Fitness checklists (asset planning and protection for business people)

Due Diligence checklists

RMA checklists

Sale and Purchase of Property checklists

LTBV and a whole lot of other business and other immigration checklists

And heaps of other checklists and topical BLOGS about building, construction, house purchases, employment law changes and so on ...and it's all FREE!!

Some of the information is simple and some very sophisticated.

People can also use the Google translator and we are also just now getting our Weibo page developed for our Chinese clients.

THANKS

YOU ARE MOST WELCOME

Disclaimer: We have taken every care to ensure that the information given is accurate, however it is intended for general guidance only and it should not be relied upon in individual cases. Professional advice should always be sought before any decision or action is taken.

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