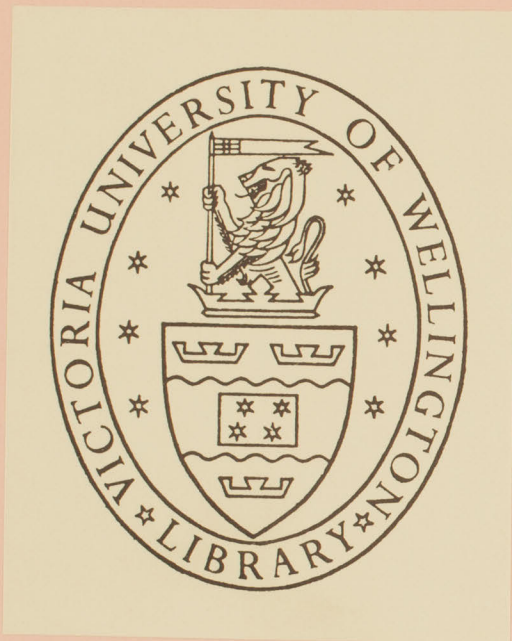


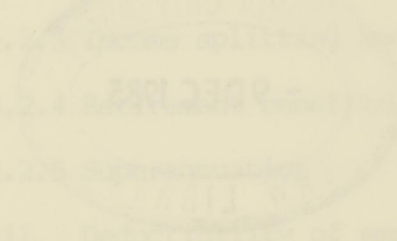
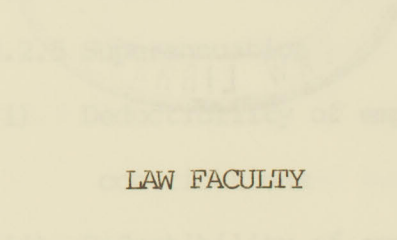
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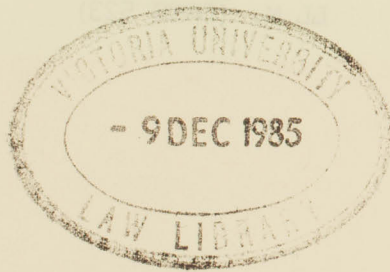




<u>TABLE OF CONTENTS</u>	<u>PAGE</u>
<u>Part 1 INTRODUCTION</u>	1
<u>Part 2 PUBLIC POLICY AND THE CONCEPT OF THE</u> <u>LEGAL PROFESSION</u>	5
MARK RODGERS	
2.1 The legal profession	3
2.2 The concept of a profession	7
THE INCORPORATION OF LEGAL PARTNERSHIPS	7
- The Changing World of the Legal	
Profession	
<u>Part 3 INCORPORATION</u>	17
RESEARCH PAPER FOR BODIES CORPORATE AND	
UNINCORPORATE	17
3.1 The Advantages of Incorporation	17
3.2 Taxation Advantages of Incorporation	19
3.2.1 The partnership tax base	20
3.2.2 L.L.M. (LAWS 523) of earnings	21
3.2.3 Income splitting and alienation	23
3.2.4  of earnings	25
3.2.5  of employee	27
LAW FACULTY	28
(ii) Deductibility of employee	28
VICTORIA UNIVERSITY OF WELLINGTON	32
3.2.6 Provisional taxpayer status.	33
3.3 Ancillary Advantages of Incorporation	34
3.3.1 Continuity - perpetual succession	34
3.3.2 WELLINGTON 1985	36
3.3.3 Liability	42
3.4 Conclusion	45

THE DEPARTMENT OF LEGAL STUDIES

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LAW FACULTY

VICTORIA UNIVERSITY OF WELLINGTON

455921

LEGAL DEPARTMENT

<u>Part 1</u>	<u>INTRODUCTION</u>	1
	<u>THE SUPERANNUATION SERVICE COMPANY</u>	
<u>Part 2</u>	<u>PUBLIC POLICY AND THE CONCEPT OF THE</u>	
	<u>LEGAL PROFESSION</u>	
	2.1 The Legal Profession	3
	2.2 The Concept of a Profession	3
	2.3 The Present Environment	7
	- The Changing World of the Legal Profession	
	<u>Part 3</u>	
<u>Part 3</u>	<u>INCORPORATION</u>	
	3.1 The Move to Incorporation	17
	3.2 Taxation Advantages of Incorporation	
	3.2.1 The partnership tax base	20
	3.2.2 Capital - retained earnings	21
	3.2.3 Income splitting and alienation	23
	3.2.4 Retirement benefits	25
	3.2.5 Superannuation	27
	(i) Deductibility of employer contributions	28
	(ii) Deductibility of employee contributions	32
	3.2.6 Provisional taxpayer status.	33
	3.3 Ancillary Advantages of Incorporation	
	3.3.1 Continuity - perpetual succession	34
	3.3.2 Administration	36
	3.3.3 Liability	42
	3.4 Conclusion	45

Part 4 PARTIAL INCORPORATION

- THE SUPERANNUATION SERVICE COMPANY

6.1 The Law Practitioners Act 1982	82
4.1 Introduction	47
4.2 The Service Company in Operation	48
4.3 The Development of the Service Company	52
4.4 The Commissioner of Inland Revenue	55
4.5 The Multi Practice Service Company	57
4.6 Conclusion	65

Part 5 THE UNLIMITED COMPANY

5.1 Introduction	67
5.2 The Unlimited Company's Structure	68
5.2.1 Liability of members	71
5.2.2 Reduction of share capital	72
5.2.3 Purchase by company of its own shares	73
5.2.4 Public or private - the exempt private unlimited company	75
5.2.5 Share Capital - transfers and surrenders	79
5.3 Conclusion	81

Part 6 IMPEDIMENTS TO INCORPORATION

6.1 The Law Practitioners Act 1982	82
6.2 An Unlawful Association	87
6.3 Questions of Ethics	89
6.3.1 Accountability	89
6.3.2 Independence and conflicts of interest	92
6.3.3 The code of ethics	93
6.4 Conclusion	94
<u>Part 7</u> <u>CONCLUSION</u>	95
<u>FOOTNOTES</u>	98

Part 1 INTRODUCTION

There is nothing more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. Because the innovator has for enemies all those who have done well under the old conditions, and lukewarm defenders in those who may do well under the new.¹

Under existing legislation in New Zealand, persons engaged in business and commercial enterprises have the freedom to elect how they should structure and conduct their affairs. Invariably this election is solely a matter of individual choice which is based upon the relative taxation and administrative advantages of the corporate versus the unincorporate form.

Such freedom of choice has traditionally been denied to the legal profession, opposition to incorporation centering upon the belief that a lawyer should bear full individual responsibility for the services he provides. Accordingly, due to legislative and ethical constraints that prohibit incorporation, together with traditional policy considerations, the conduct of the legal profession in New Zealand has been confined to the vehicle of the partnership.

It is not the intention of this paper to suggest that all law firms must or should incorporate. It is the intention to demonstrate that the continued prohibition on the legal profession practising in corporate form is both inequitable and unnecessary; that the legal profession should, like any other business venture, have the freedom of choice as to how it will conduct its affairs.

The position was succinctly stated in In Re the Florida Bar:²

If a means can be devised which preserves to the client and the public generally, all of the traditional obligations and responsibilities of the lawyer and at the same time enables the legal profession to obtain a benefit not otherwise available to it, we can find no objection to the proposal.

It is the intention of this paper to show that a means has been devised to preserve the traditional obligations and responsibilities of the law profession whilst at the same time gaining significant taxation advantages. To that end, the paper first briefly examines the background - the concept of the legal profession and the changing market place in which it finds itself having to cope; it then analyses in depth the advantages of incorporation for superannuation purposes; before examining the unlimited liability company; and finally, the impediments to incorporation.

Part 2 PUBLIC POLICY AND THE CONCEPT OF THE LEGAL PROFESSION

2.1 The Legal Profession

The status conferred upon a practitioner by his admission to the profession of law is one which confers upon him a number of privileges - some of a legal nature and some less easily defined, but perhaps of even greater significance. Of the former for example, the exclusive rights of audience before the courts and many tribunals, and, the virtual monopoly by statute, of conveyancing. In the latter category, there are the social standing, the confidence placed in his advice or guidance - often whether of a legal nature or not - and, above all, the general public acceptance of his integrity, truthfulness and creditworthiness.

In the present century, legal practitioners have inherited these privileges easily, but having done so they are now seeing the erosion and dilution of them as competition develops in the market place and the traditional concept of a profession places them at a financial disadvantage.

2.2 The Concept of a Profession

Reference has been made to the concept of a "profession", and it may be that no attempted definition will adequately describe the ideals which individuals will attach to that concept. Two standard works contain definitions which go some way to express the essential elements:³

A vocation in which a professed knowledge of some department of learning or science is used in its application to the affairs of others or in the practice of an art founded upon it.

and:⁴

A calling requiring specialised knowledge and often long and intensive preparation including instruction in skills and methods as well as in the scientific, historical or scholarly principles underlying such skills and methods, maintaining by force of organisation or concerted opinion high standards of achievement and conduct and committing its members to continual study and to a kind of work which has for its prime purpose the rendering of a public service.

These definitions embody what it is suggested may be referred to as the original qualities and attributes of a profession - that a profession connotes a high level of skill achieved through intellectual and practical training; that the professional person is dedicated to his vocation and the practice of it for the public good; and that the independence of the profession is maintained by high standards of conduct.

As is noted by one commentator:⁵

Members of the so-called "old" professions - the law and medicine - were the first to take a firm stand upon those [original qualities and attributes] and to build upon them with high standards of integrity in their relationship with clients which included the avoidance of conflicts of interest, the concept of

service before self and the principle of dealing on the basis of the utmost confidentiality. The very fact that a professional is proud of these qualities and standards is itself beneficial to the client because it means that there will be no bowing of the knee to the powerful - the professional by being a professional has the determination and strength to give his all in the client's interests - and he is not influenced by mere material considerations into giving less than his best. As the old professions became organised, these qualities and standards were institutionalised in the form of rules of ethics, rules of conduct and procedures to discipline those members of the profession who failed in some respect to adhere to those rules.

A majority of the standards and qualities representative of a profession have been enshrined by the legal profession in the Law Practitioners Act 1982 and the New Zealand Law Society's Code of Ethics. For example, the high level of learning and skill required of a candidate for admission to the profession is governed by sections 44 and 45 of the Law Practitioners Act 1982; that he is of good character and is a fit and proper person for admission, by section 46; and that if he fails to maintain the high standards set he will face internal discipline, pursuant to Part VII of the Act.

That it is a fundamental characteristic of the legal profession to serve the public or to render a public service, is an aspect of the definition that of itself is not decreed in any statute. The Code of Ethics does

address this aspect obliquely in Rule 1.1.4 which provides that a practitioner shall not refuse to act for any client except in certain specified situations. However, it is suggested that rendering a public service does not merely refer to serving an individual client's interests, but incorporates a recognition that the obligation to the general public good must prevail over that obligation to the individual client. This was noted by Lord Reid in Rondel v. Worsley, when commenting upon the duty of a barrister:⁶

As an officer of the Court concerned in the administration of justice, he has an overriding duty to the Court, to the standards of his profession, and to the public, which may and often does lead to a conflict with his his client's wishes or with what the client thinks are his personal interests.

Counsel must not mislead the Court, he must not lend himself to casting aspersions on the other party or witnesses for which there is no sufficient basis in the information in his possession, he must not withhold authorities or documents which may tell against his client but which the law or the standards of his profession require him to produce.

It is this larger concept of public service before self, or the social purpose of the lawyer, which it is submitted must be regarded as paramount to the whole concept of the legal profession. This is the cornerstone of the profession. The attributes and characteristics that have been discussed, many of which have been

enshrined in statute or in ethical codes, are simply the means by which the social purpose of the profession is advanced.

In a time of vast change in the commercial market place, although the social purpose of the lawyer and the profession as a whole remains unaltered, the profession must be capable of permitting change in order that the ability to serve the public is not prejudiced. Such change does not go to the essence of the profession or to its function, but merely to the means by which its social purpose is advanced.

2.3 The Present Environment - The Changing World of the Legal Profession

It is commonly said that change is the law of life. From the point of view of the legal profession this could be turned around to read, the life of the law is change. Certainly at the present time lawyers in New Zealand, as well as elsewhere, are having to cope with and prepare for changes that are unprecedented. Such changes are not confined to legislative changes. In the context of the concept of a profession such changes encompass the removal of monopolies; the abolition of scale ad valorem fees; the introduction of individual advertising; the blurring of of inter-professional boundaries; and a cynical, well educated and enquiring public demanding more efficient service at reasonable cost.

It could be contended that the legal fraternity has in the last few years been dragged reluctantly into the free-market commercial arena of the twentieth century, only to find that just around the corner is the twenty-first century.

The whole understanding of what the legal profession is, what its social role is, how it operates, whether it is efficient, what its economic base is, and what its professional ethics and standards are, are all matters that are currently undergoing a transformation. Because most of these questions are approached in the traditional manner, as being separate and distinct, the extent of the revolution is generally overlooked.

As was noted by Mr B. Slane, the retiring President of the New Zealand Law Society, similar upheavals are being encountered overseas:⁷

...practice overseas is not all that different, and they are encountering just the same sort of problems, just the same sort of issues and they are arising in just the same sort of ways. We do not have to reinvent the wheel on every issue. We can look and see what is happening, we can find out what others have said and done, we can learn, research and improve our thinking by contact with lawyers from overseas.

In New Zealand it was noted recently by the Rt. Hon. Mr Lange, M.P., Prime Minister, that law is part of the social fabric of society and that changes in society inevitably affect the law and the role of lawyers.

Speaking at a Bar dinner given in his honour by the Auckland District Law Society, and commenting upon such change, he commented:⁸

New Zealand lawyers...seem to be making a fair attempt to cope with increasing consumer demands for greater accountability and competitiveness. The set scale for conveyancing fees was abolished last year and the go ahead given for individual advertising. Two years ago in an address to the Wanganui District Law Society I said I saw no reason why the principles of the free market should not be applied to the legal profession. I reiterate this view. The legal profession cannot retreat behind its traditional aloof image and isolate itself from the demands of today's consumers. People expect value for money and are no longer content to unquestioningly accept set prices.

Regardless of the root-cause - be it consumerism, the increasing trend to a deregulated, free market economy, or a combination of many factors - the shape of the legal profession both in New Zealand and overseas is inevitably changing.

One of the privileges enjoyed by the profession, that of the monopoly in respect of conveyancing, is currently under threat from the Hon. Mr Goff, M.P., Minister of Housing. It would appear that, apart from endeavouring to enforce the Prime Minister's "free market principle", the Minister of Housing's fundamental aim is to reduce the cost of conveyancing by introducing competition. In a recent press release he was reported as saying:⁹

I believe that for far too long in New Zealand there has been a monopoly on conveyancing services. I think the Law Society themselves have recognised that and have taken important first steps towards reducing the impact of the monopoly [by the abolition of set scale fees]. I believe that the action we take will further encourage the Society on that path.

The Minister of Housing refers to the abolition of the ad valorem scale fees for conveyancing, finally abolished in October of 1984 largely as a result of consumer pressure. The move was initially seen as a means of developing competition between practitioners, thereby reducing conveyancing costs. The move was hailed by the Hon. Mrs Shields, M.P., the Minister for Consumer Affairs, as one giving an important lead to other professions in recognising the main principle of consumer protection. She stated:¹⁰

Consumers have a right to be fully informed before making their decisions on acquiring goods and services.

Likewise the abolition of scale was welcomed by a wide range of interested parties, although one newspaper suggested that the move was prompted by a desire "to act before being forced to do so by a consumer conscious government".¹¹

Not only has the New Zealand Law Society sought to enhance the public image of the profession by initiating such changes, but it has taken things a step further in actively promoting and marketing those changes. In the case of the abolition of the ad valorem scale of fees,

details of the changes were sent to a wide range of interested groups and individuals: the news media, Members of Parliament, the Consumers Institute, the Real Estate Institute, Citizens Advice Bureaux, the Department of Trade & Industry, the Justice Department, the Treasury, the Building Societies Association, savings and trading banks, professional bodies representing accountants, valuers, architects, farmers and commerce. Additionally a pamphlet was produced, entitled "Best Value from your Lawyer", approximately 40,000 of which were distributed to the country's courthouses; and a television commercial was produced to publicise the new costing procedures.

From publicising the abolition of the scale and the new costing procedures, the New Zealand Law Society followed its overseas compatriots and in early 1985 decided to permit individual advertising by members of the profession. Whilst strict guidelines have been established as to the content of any advertisement, and the stated purpose of this relaxation of the rules was to permit practitioners to advise the public of any particular specialisation they offered, advertising is of itself essentially market orientated and competitive.

Whilst the New Zealand Law Society has reacted rather more quickly than the legal profession in many other countries to the exposure of the profession to market forces, the initial impetus for change came from the United Kingdom.

Following a major report published in the United Kingdom in 1970¹², the Monopolies and Mergers Commission delivered five separate reports concerning the legal profession in which it was recommended that advertising restrictions should be removed. Although the Commission's recommendation was substantially ignored it was later reiterated by a Royal Commission on Legal Services which reported in 1979.¹³

Meanwhile, in 1973, the Lord Chancellor abolished the ad valorem scale charges for conveyancing largely due to increasing dissatisfaction amongst both consumers and the profession and reports by the National Board for Prices and Incomes which concluded that the scale fee system was both expensive and inequitable. The 1979 Royal Commission recommended that the conveyancing monopoly should be retained.

Another critical move in the exposure of the profession to outside market forces came from the courts of the United States of America. In Bates v. State Bar of Arizona¹⁴ the Supreme Court of the United States legalised lawyers' advertising on the basis of the First Amendment to the Constitution, and in so doing rejected the traditional arguments for prohibiting advertising.

Two years prior to this decision the Supreme Court in Goldfarb v. Virginia State Bar¹⁵ had ruled that the imposition of mandatory minimum fee schedules by a Bar Association was contrary to the Sherman Act (the major piece of United States anti-monopoly legislation).

The profession has also come under scrutiny at an international level, with the Organisation for Economic Co-operation and Development, of which New Zealand is a member, having received a report upon Competition and the Professions¹⁶. Amongst other professions, law is examined and the report recommends the removal of scale fees and restrictions upon advertising and that the professions should get no larger exemption from competition law than is essential to the public interest.

As already noted, it is proposed by the Labour Party to end the conveyancing monopoly of the legal profession in New Zealand.

In New Zealand, the proposed competition is from the Housing Corporation. The English profession, under threat from the Farrand Committee¹⁷ which resulted from the lobbying of Mr Austin Mitchell, is likely to face competition from licensed conveyancers and quite possibly from institutions such as banks and building societies.

To some extent it appears that New Zealand's Minister of Housing is following the initial steps of the Farrand Committee, which reported back in September, 1984. If this is the case, it is quite possible that New Zealand practitioners may, in the not too far distant future, be facing wider competition than that presently posed by the Housing Corporation.

It is evident that the ever increasing exposure to public opinion and market forces has led, and is leading to, unprecedented change in the legal profession, both in

this country and overseas. For an entrenched profession, intent upon maintaining the status quo, reaction to change in New Zealand has to date been relatively prompt. It must not however be forgotten that it is the duty of the profession to serve the public.

In an opening address to the English Law Society's National Conference at Bournemouth in 1985, the Master of the Rolls, Sir John Donaldson dealt with the topic of change and reform, and in so doing set out what he considered the three essential social purposes of lawyers.¹⁸ The first was to assist the public in doing what they want to do - that is to comply with the law that applies to them. The second social purpose could be described as helping people to make sensible choices within the area of free choice that the law leaves to them, and by sensible he means the choices that will reduce or eliminate the chances of disputes arising thereafter while at the same time achieving the object that the client has particularly in mind. The third, he describes as the settlement of disputes, to be resolved as quickly and as economically as possible with a minimum of personal conflict between the parties. The social purpose or public service role of the lawyer was, considered Sir John Donaldson, the strength of the legal profession.

It is submitted that for lawyers to adequately serve the public and to fulfil their social role, they must be financially strong. Traditionally, professional people have tended to down-grade the importance of the economics of practice, upon the principle of service before self.

Lawyers hold themselves out as offering services to the public and there has often been a tendency to assume that growth and development of the practice, together with financial security, will automatically come from clients if competent legal services are provided. It appears that the assumption is often made that fees will take care of any costs incurred in running the practice. It is suggested that such an attitude is not acceptable in this day and age. A financially bereft or struggling lawyer is of little benefit to the community or the profession; it is important that if a lawyer is to serve the public he must be financially strong.

In an age of increased competition, public awareness and accountability, the maintenance or improvement of a practice's financial strength can only be achieved by increased efficiency. Increased efficiency means effective practice management on an ongoing basis. However, is increased efficiency enough?

In entering the free-market arena of business and commerce, the legal profession has for the first time, been placed on a similar footing to the small business. As in the small business, effective management, administrative and credit control systems can be implemented. However, in contradistinction to the small business, the legal firm must conduct its business by way of the medium of the partnership, with its attendant disadvantages.

Part 3 With law firms' traditional privileges being rapidly eroded, and the need to adapt to a world of free enterprise and competition, it is inequitable that law firms must operate in the same form as they did one hundred years ago. Effectively this prevents the profession from operating on the same footing as many it serves. It is suggested upon the basis of Equity that lawyers, like businessmen, should have the freedom of choice as to incorporation. Whether it be incorporation as a limited or an unlimited liability company, the traditional characteristics and values of the profession are not denigrated or impinged upon in any way. There is no incompatibility with the concept of a profession or with the overall duty of the profession to serve the public.

Why should a young solicitor enter private practice today and strive for a partnership when his rewards for accepting the duty to serve the public are a social status of diminishing standing, a steadily reducing number of monopolies, unlimited personal liability for his partners' actions, and exclusion from the taxation advantages available to employees of companies. Such a position is made even more unattractive when he has to outlay a substantial capital sum to buy his way into this position.

If lawyers are to maintain standards and efficiency and serve a demanding, consumer orientated public, they must have the freedom of choice.

Part 3 INCORPORATION

3.1 The Move to Incorporation

In early 1983, a proposal to investigate the "pros and cons" of incorporating legal firms as unlimited liability companies was approved by the New Zealand Law Society. This proposal, sponsored by the Auckland District Law Society which subsequently established a committee to complete a report to the New Zealand Law Society, noted three distinct advantages in incorporation.¹⁹

Firstly, a continuity of identity, in that the legal entity of the incorporated legal firm would remain the same with any change of "partners", and the formalities of dissolution and re-establishment of a true partnership would no longer be necessary; secondly, it was suggested that the accounts of an incorporated firm would be easier to keep; and thirdly, that such a firm could establish a superannuation scheme for its directors with the employing company able to make tax deductible contributions.

Such an initiative as that of the Auckland District Law Society is not novel in this country - a paper upon the incorporation of legal firms having been presented at the conference on Law Reform held by the University of Auckland Law Students Society as long ago as April 1965.²⁰ In this paper however a more radical approach was taken by the authors and limited liability suggested as being the appropriate vehicle.

More recently in the Australian State of Victoria, the State Attorney-General agreed in principle that law firms should be permitted to incorporate in limited liability form - in this case however, with blanket guarantees from the shareholders/solicitors - and he agreed to place such a proposition before cabinet.²¹ In this instance it was suggested that incorporation could have a number of advantages for both large and small practices, as a means of increasing capital bases and simplifying administration.²²

In contrast to Victoria, in England the findings of the Benson Royal Commission²³ have been followed and the recently introduced Administration of Justice Bill (UK) includes a clause that will permit solicitors to practise as corporations with unlimited liability.

In this country it is unclear how far the working committee established by the Auckland District Law Society has progressed. It was reported in March 1985 that "following discussion in September last year of a report outlining the advantages of incorporation of a legal practice..."²⁴ two New Zealand Law Society members had been asked to investigate the changes that would need to be made to the Law Practitioners Act 1982 and subordinate legislation. However, an approach to one of those persons by the author was met by a disinterested rebuff. The last cryptic note to be published upon the matter was in June of 1985 and simply recorded:²⁵

3.2 The A legislative proposal for incorporation is being
3.2.1 The prepared for consideration by the New Zealand Law
The Society.

In contrast to the legal profession, accountants on both sides of the Tasman are looking at limited liability incorporation as being preferable to unlimited liability, as a means of containing at a reasonable and a known level, their potential liability. A move is already underway in this country to remove the only legislative impediment to incorporation outside the provisions of the New Zealand Society of Accountants Act 1958 which presently prohibits an auditor from being incorporated.²⁶ It is understood that at this stage only incorporation in unlimited form will proceed, but that as at August 1985 only the final consent of the Minister of Finance to the amendment remained outstanding.

The perceived advantages of incorporating professional partnerships, in particular legal firms, obviously vary considerably from firm to firm and partner to partner; that perception being coloured by the impact incorporation is likely to have on the individual practitioner or his firm.

To understand the advantages that are generally accepted as being available, a brief look at the taxation position of a partner is necessary.

falls within the definition of a "person" in section 2 of the Act, it is not a "taxpayer", merely being a conduit through which income is channelled to the individual partners. As was noted in *Steinberg v. F.C.T.*

3.2 Taxation Advantages of Incorporation

3.2.1 The partnership tax base

The Income Tax Act 1976, does not define a partnership for tax purposes. The reason for this is that the statute does not, as a general proposition, impose any special rules dealing with the taxation of partnerships. The most notable exception to that proposition is the requirement that a partnership must file a return of income,²⁷ and thus reference needs to be made to the general law, where the Partnership Act 1908 defines a partnership as being inter alia:²⁸

...the relation which subsists between persons carrying on a business in common with a view to profit.

In contrast to a company, a partnership is not a taxpayer in its own right, the return of income it being required to file disclosing only the detail of the partnership income and its allocation between the partners.²⁹ It is the partners themselves individually who are assessable for the allocated partnership income, the Income Tax Act 1976 providing:³⁰

There shall be no joint assessment, but each partner shall be separately assessed and liable for the tax payable on his total income, including his share of the income of any firm in which he is a partner:

Thus, although a partnership falls within the definition of a "person" in section 2 of the Act, it is not a "taxpayer", merely being a conduit through which income is channelled to the individual partners. As was noted in Steinberg v. F.C.T.:³¹

A partnership is not an entity distinct from its members, it is not the partnership that carries on the business as such, but the individual members who carry on the business in partnership.

Thus for all intents and purposes a partner is taxed as an individual tax payer. Therein lies the fundamental disadvantage.

3.2.2 Capital - retained earnings

One of the traditional problems facing partnerships in this country has been that associated with maintaining adequate capital bases for partnerships, and the cost of increasing that capital base. As partnership income is taxed in the individual partners hands, this of course means that for a partnership to build up its capital, first the individual partners must pay tax on their income before contributing the required capital.

Accordingly, where a partner's income level exceeds \$38,000.00 per annum, tax at the rate of sixty-six cents in the dollar must first be paid, which makes capital investment in the partnership a very expensive exercise. By contrast, profits retained in a company are subject to tax at the corporate rate of forty-five cents in the dollar. Thus, in a continuing and expanding business where profits are required to be reinvested to provide working capital, this retention provides fifty-five cents out of every dollar for working capital, as opposed to the thirty-four cents available if profits are taxed in the individual partner's hands.

Additionally, whilst tax at individual rates is imposed upon dividends, the need to pay dividends may not arise. It has long been the policy of the Commissioner of Inland Revenue to allow substantial flexibility in the level of salaries paid for which a deduction may be claimed.³² Accordingly profits can be retained or distributed as salaries according to a pre-determined ratio which takes into account the tax effects. At the shareholder level, retained earnings held by a company represent a deferral of tax, which may extend over the life of the company.

The Hon. Mr Douglas, M.P., Minister of Finance announced, 20 August 1985,³³ that as from 1 October 1986 the maximum individual rate of taxation would be reduced from sixty-six cents in the dollar to forty-eight cents in the dollar and that as from 1 April 1986 the company tax rate would be raised from forty-five cents in the dollar to forty-eight cents in the dollar.

With the proposed equalisation of the maximum individual rate of taxation and the corporate rate, the anomaly that has for long existed between partnerships and companies and the comparative cost of reinvesting income will be resolved. The cost of working capital to both companies and partnerships will from 1 October 1986 be forty-eight cents in the dollar.

Additionally it was announced that all dividends from capital sources would henceforth be assessable in shareholders' hands, but a full imputation system being proposed, the Government's intent being to introduce this in the 1988/1989 financial year.

This attempted neutralisation of the tax base in New Zealand is going to go quite some way in placing the corporate shareholder and the partner on the same footing. That is not to say however, that anomalies still will not exist and that taxation advantages still cannot be achieved by incorporation.

3.2.3 Income splitting and alienation

It is generally accepted in New Zealand that income derived from the provision of professional services is not capable of assignment.³⁴ Accordingly it is not possible for a partner to reduce liability for income tax by assigning the right to the partnership profits of his practice. The situation is quite different in Australia where in F.C.T v. Everett³⁵ the High Court held that a partner could assign part of his interest in the partnership, and in so doing effectively assign the income attributable to that interest thus ensuring it was no longer taxable in his hands. However, it has been made abundantly clear by the New Zealand Commissioner of Inland Revenue that he would not accept an Everett type assignment and therefore any professional who intended to emulate the taxpayer in Everett's Case³⁶ should be prepared for litigation.³⁷

By contrast, where incorporation is permitted income splitting could be achieved by transferring ownership of shares to family members or trusts or companies formed for the benefit of a "partner's" family.

The obvious barriers to such a move would be Law Society objection to other than practitioners holding shares and the Commissioner of Inland Revenue attempting to strike down any such assignment by invoking section 99 of the Income Tax Act 1976.

In order to maintain the integrity and independence of the profession, it is almost certain that the new Zealand Law Society would require shareholders of a corporate law practice to be practitioners; this is discussed more fully in Part 6. What however would be the case where, as happened in Everett's Case³⁸ the practitioner concerned assigned shares in the practice to a spouse who was also a practitioner? Granted, an unusual situation, but one not without precedent.

In such an instance, where the corporate practice had been incorporated and the shares originally subscribed for by the original partners, it is suggested that section 99 could not be invoked by the Commissioner where shares were subsequently sold to a third party. A mere sale of shares does not constitute an arrangement from which one can predicate the existence of a tax avoidance purpose.³⁹

Whilst it is unlikely that an income splitting advantage can be achieved by incorporating legal practices, it is suggested that this is because the New Zealand Law Society would require all shares to be held by practitioners, rather than because it would be barred by section 99 of the Income Tax Act 1976.

From a theoretical standpoint it may be possible where the assignment was to another practitioner, although it must be anticipated that the New Zealand Law Society would block such a move where the assignor and the assignee were not members of the same practice. This point will be covered more fully in Part 6 of this paper, but briefly, where the assignee is a shareholder of another practice, in practice alone, or, for that matter, not in practice at all, a potential conflict of interest arises and the independence of the assignor is threatened.

3.2.4 Retirement benefits

Section 68 of the Income Tax Act 1976 grants special concessions for lump sum payments made by an employer to an employee upon the occasion of that employee's retirement. In essence, section 68 provides that, so long as the quantum of the allowance paid does not exceed the average of the employee's total ^{annual?} remuneration from that service over the prior three years, then it is assessable as to five per cent only of that lump sum in the employee's hands at his marginal rate of tax. The amount receivable is reduced upon a proportional basis where the employee has had less than ten years of service. Pursuant to section 152 of the Income Tax Act 1976 the payment of a retiring allowance is generally deductible to the employer in the year of payment.

The words of section 68 refer specifically to the "employment or service" of the taxpayer and those of section 152 to an "employee" of a taxpayer.

(1) Under general law, a person cannot employ himself, and accordingly a partnership cannot employ any of its partners. Payments made for any such "employment" are treated as an allocation of profits, and are accordingly assessed as income in the individual partners' hands.

There is a statutory modification to the general proposition that a partner cannot be an employee, contained in section 167B of the Income Tax Act 1976 to the effect that a deduction will be available for payments made by a partnership to any working partner for services performed under a contract of service. However it is suggested that such a modification is limited to its own situation, and cannot be seen as conferring a statutory legitimacy to the notion that as a partnership can enter into a contract for services with one of its number, it should equally be possible to argue that this legislative sanction enables a partner to be an "employee" for the purposes of section 68 of the Act.

In contradistinction to the corporate employee, the partner of a professional partnership, not having available to him the concessional taxation regime of section 68, is severely prejudiced.

The following example illustrates the tax benefit which may be available to a retiring shareholder employee, contrasted with the retiring partner:⁴⁰

(i) Retiring Partner	Gross	Tax	Net Income
	\$	\$	\$
1983	70,000	36,000	34,000
1984	80,000	42,000	38,000
1985	<u>90,000</u>	<u>48,000</u>	<u>42,000</u>
Total	<u>240,000</u>	<u>126,000</u>	<u>114,000</u>
(ii) Retiring Shareholder-employee			
1983	60,000	30,000	30,000
1984	60,000	30,000	30,000
1985	60,000)		
)	32,000	88,000
Retiring Allowance	<u>60,000)</u>	<u> </u>	<u> </u>
Total	<u>240,000</u>	<u>92,000</u>	<u>148,000</u>
Saving in Taxation			<u>34,000</u>

In both instances the cost to the practice remains the same (ie. \$240,000) however in the retiring shareholder-employee situation he receives an additional benefit of approximately \$34,000, through reduced personal taxation.

3.2.5 Superannuation

The inability of a partner to take advantage of employer subsidised superannuation is probably the single greatest disadvantage resulting from the legal profession's inability to incorporate. To fully appreciate the situation an overview of the legislation regarding superannuation is required.

The most important piece of legislation affecting the design and operation of private superannuation schemes in New Zealand is the Superannuation Schemes Act 1976, which provides that approval of such schemes is the responsibility of the Government Actuary. The Act requires the Government Actuary to approve a scheme for which his approval is sought, if:

- (i) the scheme meets the conditions prescribed in the Act and Regulations, and,
- (ii) he is satisfied that the interests of the members are adequately secured.

The Act itself contains little detail of the conditions which proposed schemes must meet to obtain approval, these conditions being prescribed in the Superannuation Schemes Regulations 1983.

There are no penalties contained in the Superannuation Schemes Act 1976 itself, for failure to secure the Government Actuary's approval. However, only private superannuation schemes which are approved under the Act can enjoy the advantages provided by the Income Tax Act 1976. The disadvantages of not obtaining approval are so severe, that for practical purposes it can be said that superannuation schemes in New Zealand are compelled to be approved under the Superannuation Schemes Act 1976.

3.2.5 (i) Deductibility of employer contributions

An employer's contributions to an approved superannuation scheme for his employees are deductible in calculating the employer's assessable income, to the extent permitted

by section 150 of the Income Tax Act 1976. Section 106 (1) (m) of that Act provides that any contribution by the employer which is not deductible pursuant to section 150, cannot be deducted under any other provision of the Act. Generally speaking, the employer's contributions to an approved scheme are fully deductible in calculating his assessable income, up to a limit of ten per cent of the total earnings paid by the employer to his employees who are members during the relevant tax year.⁴¹

Section 150 (4) of the Income Tax Act 1976 vests in the Commissioner of Inland Revenue a discretion to disallow a deduction for contributions paid by a company to a superannuation scheme for the benefit of a shareholder-employee of the employing company.

The Act provides that the term "shareholder-employee" in relation to any income year and to any company:⁴²

...means any person who, at any time in that income year, is an officer or employee of that company and who-

- (i) At any time in that income year holds 20 per cent or more of the paid-up capital, or of the nominal value of the allotted shares, or of the voting power in that company; or
- (ii) At any time in that income year has, by any means whatsoever, control of the company; or
- (iii) By reason of his shareholding at the end of that income year would be entitled to 20 per cent or more of the profits of that company for that income year if those profits were distributed by way of dividend at the end of that year;

That Act then goes on to provide that:⁴³

Where directly or indirectly a nominee of any person holds any paid-up capital, or any allotted shares, or any voting power in the company, or is entitled to a share of profits distributed by a company, that paid-up capital, or those allotted shares, or that voting power, or that title to profit, as the case may be, shall be deemed to be held by that person; and for this purpose the term "nominee" includes any relative of that person and the trustees of any trust under which that person or any relative of that person is a beneficiary.

Thus, in general the expression "shareholder-employee" means a person who is an employee or officer of a company and who holds twenty per cent or more of the capital or of the voting power in that company. Shares held directly or indirectly and also shares held by relatives are included in deciding whether or not the employee has twenty per cent of the shares in a company. It is the position of the Inland Revenue Department that no deduction will be permitted in respect of contributions for the benefit of an employee deemed a "shareholder-employee".

Further constraints have been placed upon "shareholder-employees", section 2 of the Superannuation Schemes Act, 1976, defining the term "employee" as meaning:

... any person who is engaged to work ... under a contract of service ... with an employer ... but does not include any person who would be a shareholder-employee within the meaning of section 150 (1) (d) of the Income Tax Act 1976 if the expression "20 per cent" was omitted from sub-paragraphs (i) and (ii) of that provision and the expression "50 per cent" was substituted in each case.

The net effect of this provision, which was introduced following the 1982 Budget, is to preclude principal shareholders from being classified as "employees" in terms of the Superannuation Schemes Act 1976, thereby ensuring that they cannot be members of an approved employee subsidised superannuation scheme.

Therefore, the current situation as to deductibility of employer contributions to a subsidised scheme can be summarised as thus: a shareholder holding directly or indirectly fifty per cent or more of the capital or voting power of a company cannot be a member of that company's scheme. If that shareholder holds twenty per cent but less than fifty per cent of the capital or voting power, he can be a scheme member, but there can be no deductibility in respect of contributions made by the company upon his behalf. Where a member holds less than twenty per cent, he can be both a member, and the company can claim a deduction in respect of contributions made on his behalf, of up to ten per cent of the wages bill of the members of the scheme.

3.2.5 (ii) Deductibility of employee contributions

An approved superannuation scheme is included within the term "specified fund" for the purposes of section 59 of the Income Tax Act 1976, and a member's contributions to such a scheme accordingly qualify for a deduction by way of special exemption within the limits of that provision.⁴⁴ Any member's contribution which is not deductible under section 59 because the superannuation scheme is not approved is not otherwise tax deductible.⁴⁵

It is obvious from the foregoing discussion, that for a person to avail himself of tax sheltered superannuation, the scheme to which he belongs must first gain the approval of the Government Actuary, in terms of the Superannuation Schemes Act 1976. However, we have seen that only "employees" can be members of approved schemes. Unfortunately, it has long been settled law that a partner cannot be both a partner and an employee of the partnership at the same time.⁴⁶

If he could be, he would be the employer of himself. Such logic of course applies equally to the sole practitioner. Stated simply, the provisions of the Income Tax Act 1976 provide tax sheltered superannuation only to those who are afforded, in this instance the luxury of incorporation; furthermore, due to the definition of an "employee-shareholder",⁴⁷ a minimum of six equal shareholders is required if all are to receive the benefit of a superannuation scheme.

3.2.6 Provisional taxpayer status:

As provisional tax payers, the position of partners upon the incorporation of their practice need not change. Whilst no major advantage is gained by maintaining provisional taxpayer status, it does permit a taxpayer a little more flexibility in short term financial planning by reason of the ability to estimate the next year's income tax liability by reference to the prior year's tax liability, and to pay the final instalment of income tax a year in arrears.

A provisional taxpayer is defined by section 377 of the Income Tax Act 1976 to be a person other than a taxpayer whose income consists solely of source deduction payments. A "source deduction payment" is defined by section 6 (1) of the Income Tax Act 1976 to mean "... a payment by way of salary or wages, an extra emolument, or a withholding payment". Accordingly, as "salary or wages" are defined in section 2 of the Act as including periodic payments in respect of employment, regular pay or salary from employment is subjected to P.A.Y.E. and excluded from provisional income.

Section 6 (2) of the Income Tax Act 1976 makes provision for shareholder employees in private companies to be treated as provisional taxpayers in certain circumstances. Whilst the Commissioner of Inland Revenue has a discretion in the application of the provision, his current rulings may be summarised as follows:

Taxation is to be deducted from:-

- Amounts paid to shareholder-employees as a regular salary for pay periods of one month or less

- Other payments made to those shareholder-employees unless the Inland Revenue Department agrees to the other payments being treated as provisional income.

Taxation is not deducted from:-

- Amounts paid to shareholder-employees where no regular salary is paid. These persons pay provisional tax on their total income from the company.

Bearing the Commissioner's attitude in mind it becomes relatively simple to avoid becoming a P.A.Y.E taxpayer by ensuring that "salaries" paid to shareholder-employees are treated as advances. Such advances would be minuted at the commencement of the financial year, whilst the actual salary would be determined at the close of the financial year. Until such time as salaries had been determined at the end of the financial year, a liability would be upon the shareholder-employees to repay the advances if so required.

Upon this basis there is no reason why upon the incorporation of a practice that the "partners", now being shareholder-employees should lose their status as provisional taxpayers and the advantages consequent upon that status.

3.3 Ancillary Advantages of Incorporation

3.3.1 Continuity - perpetual succession

The Partnership Act 1908, provides as follows:⁴⁸

Subject to any agreement between the partners, every

partnership is dissolved as regards all the partners by the death or bankruptcy of any partner. // Although it is now commonplace to provide in partnership agreements for the continuance of the partnership by the survivors in the event of a partner's death, where no such provision has been included, the death of a partner operates as a complete dissolution of the firm, and necessitates a winding up.⁴⁹ Similarly with the withdrawal, retirement or expulsion of a partner, the partnership is faced with a dissolution which of course has an impact upon any contracts entered into by the firm, in particular any lease. By contrast a company has perpetual succession,⁵⁰ and in the ordinary course of events the death, bankruptcy, withdrawal or retirement of a shareholder would have no impact upon the continuity of that company's identity. No need for a winding up arises, nor would the necessity of re-executing leases and contracts occur. Quite simply one shareholder employer would have left the company, in all probability to have been replaced by another.

One could speculate, that the perpetual succession of an incorporated legal practice could lead to the acquisition of the advantages at present enjoyed only by trust companies, in that the legal company could be appointed as executor and trustee of wills and settlements as opposed to an individual solicitor. This would certainly provide a means of circumventing the extraordinary results achieved by the present system, whereby a deceased solicitor's administrator may become the executor of many wills of clients he has never met.

It is evident however, that an incorporated legal practice could not become a trustee company. Section 2 of the now repealed Trustee Companies Act 1960, defined a trustee company as:

... a company that is authorised by any Act of the General Assembly to administer the estates of deceased persons and other trust estates.

Accordingly a trustee company was one created by the passing of a specific enabling Act.

Section 2 of the Trustee Companies Act 1967 provides that the expression "trustee company" means any of the five trustee companies named in that section. It should be noted that those five companies are the only trustee companies in New Zealand, and that the last was formed in 1934.⁵¹ It is thus evident that there is no legislative intent to create further trustee companies; there existing, as it were, a closed shop.

Additionally, where a company has not the express authority of an Act of Parliament, it is prohibited by section 63 of the Administration Act 1969 from receiving either a grant of probate or letters of administration.

3.3.2 Administration

The recent on-off saga involving the international accounting firms of Price Waterhouse and Deloitte Haskins and Sells, and their proposed merger on a world wide basis, although in the context of legal firms a very exaggerated example, throws into focus the laborious decision making process of large partnerships, and the

time and money wasting process of involving every partner in a decision, which would be more logically, from a business sense, made by a small board of directors.

Had the two boards of directors been able to get together and negotiate, as opposed to allowing every partner from each firm, world-wide, to vote on the issue, the merger may have gone ahead. Whilst a centralised management committee of a large partnership may to some extent achieve the same ends as a company's board of directors, the fact remains that the powers, duties and liabilities of directors are statutory, and certain.

Although the number of partners in a law firm in this country is, by virtue of section 456 of the Companies Act 1955, limited to fifty, it is highly likely that if incorporation of law firms is allowed to proceed, then the permitted number of partners in a law partnership will be reduced to twenty-five. Whilst this may sound incongruous in view of the recent number of mergers within the profession, the advent of firms with partners and offices in three or more New Zealand cities and the likelihood of national and even trans-Tasman firms,⁵² it simply means that section 456(1) of the Act dictates that the profession cannot have both the right to incorporate and the right to partnerships with more than twenty-five members.

Section 456(1) of the Companies Act 1955 provides, inter alia, that:

... no company, association, or partnership consisting of -

- (a) More than fifty persons in the case of a company, association, or partnership formed for the purpose of carrying on any profession or calling declared by the Governor-General by Order in Council to be a profession or calling that ~~this~~ ^{is} not ^{customarily} carried on by a body corporate; or
- (b) More than twenty-five persons in any other case...

In terms of section 456(1) (a) of the Act the law has been declared a profession not customarily carried on by a body corporate.⁵³

It is contended that where a profession is given the choice of whether to incorporate or not, that profession cannot in terms of section 456(1) (a) of the Companies Act 1955 expect to remain designated as "... a profession or calling that is not customarily carried on by a body corporate; ...". Accordingly, unless this provision can be amended, the profession must make a decision - large partnerships only, or smaller partnerships and companies?

Additionally, the administration of a company where shareholders transfer their shares upon retirement or withdrawal from the company would provide a welcome alternative to the dissolution of a partnership and the formation of a new partnership.

As will be discussed in Part 6, it must be anticipated that the New Zealand Law Society in permitting the incorporation of law firms will be adamant in requiring that only practitioners may be directors and shareholders and therefore the question of the trustees or beneficiaries of a deceased shareholder's estate participating in the company should not arise.

Regardless, the company's Articles of Association should restrict membership to qualified practitioners, and compel the surviving members to purchase the interest of a deceased shareholder. Although every shareholder has a prima facie right to transfer his shares,⁵⁴ this right may be severely restricted by the Articles. As was noted by Lord Cairns L.C. in Ashbury Railway Carriage Co. v. Riche⁵⁵:

The memorandum is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit.

Whilst some restraint has been placed upon Articles that have been adjudged unfair or repugnant,⁵⁶ it is submitted that so long as a provision for the compulsory purchase of shares is exercised bona fide for the benefit of the company as a whole, and not merely the interests of the majority, then such an article will be valid.⁵⁷

In Rayfield v. Hands⁵⁸ where the Articles of a private company provided that "... every member who intends to transfer shares shall inform the directors who will take the shares between them ..." it was held that directors were bound by the equivalent of section 34(1) of the

Companies Act 1955, to purchase the shares. The court limited the application of the decision to private companies that bear a close analogy to partnerships.

Additionally it has been held that a provision to the effect that in the event of bankruptcy, a member should sell his shares to a particular person at a particular price is valid unless the price stipulated is unfair.⁵⁹ Likewise an Article to the effect that the company could by resolution require a member to sell his shares to the other members at a price fixed by the resolution was held valid.⁶⁰

Accordingly it is submitted that, as the Articles of Association of a company constitute a contract between each member and every other,⁶¹ and that as a general rule an Article will be upheld unless it is unfair or repugnant,⁶² there can be no reason why shareholders cannot be compelled to purchase another's shares, whether he be deceased, retired or expelled from the company.

As an alternative to the compulsory purchase of shares by the members, where the company in question was an unlimited company with a share capital, the shares of a deceased, retiring or expelled member could be surrendered to, or redeemed by the company and cancelled. Although a redemption of shares constitutes a reduction of capital, in the case of an unlimited company this is possible without the consent of the court, and, accordingly with relative ease, shares may be issued and redeemed at will.

3.2.3 Whilst this scheme is discussed at length in Part 5 of this paper, the point for present purposes is that a deceased, retiring or expelled member's shares could be redeemed by the company without the necessity of the remaining members having to dip into their own pockets to purchase the shares.

Whether or not the shares in question are purchased by the remaining shareholders or redeemed by the company, the purchase or, as the case may be, surrender will be for value. What value is to be ascribed to a share is a question to be addressed by the members. A formula could be built into the Articles, or alternatively reliance could be placed upon a valuation whenever shares were to be disposed of. Due to the inability of most valuation formulae to take account of all relevant factors whilst at the same time catering for all, it is suggested that incorporating practices would be most likely to leave share valuation until the actual need arose.

The corporate structure would also facilitate the raising of outside capital, in that a floating charge could be created over the professional company's assets. As such a charge may be secured by current and future assets, the borrower is able to offer the lender greater security than is generally available where only fixed assets are available as security.

3.3.3 Liability

A partner of a law firm is subjected to unlimited personal liability in respect of his own professional misconduct, and also claims against the partnership which may not be connected with any personal wrong on his part. Such claims against the partnership may be in respect of either professional or non-professional liabilities.

In order to protect himself against such claims, it is normal for the professional person to take professional indemnity insurance. Although such cover is not yet compulsory for New Zealand law practitioners, it is an often discussed topic, and a compulsory scheme is likely to be instituted in the near future.

The cost of professional indemnity cover for both solicitors and accountants has increased dramatically in recent years, to the extent that the accounting profession faced a thirty per cent increase in premium cost this current financial year, and the organising brokers maintain that the underwriters did well to keep the cost increase below fifty per cent.⁶³ Such costs have now risen to the extent that a Wellington partner of a national accounting practice recently advised the author that his personal share of the firm's premium cost was in the very high four figure region. Even then he stated, the firm's level of cover was woefully inadequate.

The cost of professional indemnity cover has increased dramatically, as the overseas claims experience suffered by the underwriters, especially in relation to accountants, has steadily deteriorated.

For example, a recent award of \$145 million damages against the former auditors of Cambridge Credit Corporation in Australia,⁶⁴ and the rumoured greater than one million dollars out of Court settlement in New Zealand by national accounting firm Touche Ross, in favour of the receiver of the Securitibank group of companies.

Whilst claims of such mammoth proportions have not been experienced by the legal profession in New Zealand nor Australia, and it is unlikely that they will be⁶⁵, the size of claims are increasing as are the costs of cover⁶⁶.

A partner's liability for the acts of his co-partner is found in section 15 of the Partnership Act 1908, which provides,

Every partner is liable jointly with his co-partners and also severally for everything for which the firm while he is a partner therein, becomes liable...

Can such a liability realistically be avoided by a solicitor or an accountant incorporating a limited liability company to conduct his practice? It is suggested that the answer must be "No".

It was noted in the Benson Report⁶⁷ that the advantages of a solicitor carrying on his business in limited liability form in order to limit his liability against substantial monetary claims for negligence were more apparent than real. The Law Society (UK) evidence to the Commission noted:⁶⁸

...it would, no doubt, limit the liabilities of the company in matters such as trading debts, but in respect of the firm's professional liabilities to clients (and perhaps others) it is likely that solicitor-members of the firm would continue to be liable in full for their own negligence unless express contractual exclusions or limitations were effectively imposed.

Although a member of a corporate law practice would remain personally liable for his own negligence, his fellow members are not jointly and severally liable for his acts or omissions. Where an action is brought against the company the members' liability is limited to the extent of their capital, and in this regard two points should be made. Firstly, that not many professional people would be willing to let their company go under and forfeit their investment; secondly that overseas experience would indicate that whenever a profession has been permitted to adopt limited liability status, the governing professional body has required the professional corporation's shareholders to indemnify the company without limitation upon their own liability⁶⁹.

Similarly, in the case of a partner's continued liability after retirement or withdrawal from the partnership, whilst incorporation may limit that liability, the practicalities of the situation would maintain his liability.

Section 12 of the Partnership Act 1908, provides that:

Every partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in a due course of administration for such debts and obligations as far as they remain unsatisfied, but subject to the prior payment of his separate debts.

Such continued liability following the cessation of membership of a partnership is in direct contrast to the position of an ex-shareholder of a company, whether limited or unlimited. Pursuant to section 211 of the Companies Act 1955, a member ceases to be liable in a winding up, one year after terminating his membership of that company. Accordingly, in an incorporated law practice an ex-member would not be liable for the debts and obligations of that company, incurred whilst he was a member.

However, this advantage of incorporation is likely to be nullified by a retiring member being called upon to indemnify the company in respect of debts and obligations incurred whilst he was a member.

3.4 Conclusion

It is obvious from the foregoing discussion that the principal advantages of incorporating a law practice are taxation orientated. Tax-sheltered, employer-subsidised superannuation is available to the company member, as is a lump sum, substantially tax free retiring allowance.

Assuming that the present Government's intention to equalise the top marginal rate of personal income tax and the company rate proceeds as planned, the corporate form will no longer offer an advantage in accumulating capital. Likewise given the present attitude of the Commissioner of Inland Revenue, together with the anticipated requirements of the New Zealand Law Society that only practitioners be company members, the opportunity for income splitting or assignment of income will not arise.

It is suggested that any other advantages of incorporation such as perpetual succession and ease of administration are incidental to the main tax related purposes, and that an avoidance of liability via the medium of the limited liability company is purely illusory.

Part 4 PARTIAL INCORPORATION - THE SUPERANNUATION SERVICE COMPANY

4.1 Introduction

Partial incorporation in order to obtain the advantages of superannuation is not a novel concept for the legal and accounting professions in New Zealand.

The concept of the Administration Company (or, as it has become known in this country, the Superannuation Service Company) evolved in Australia around about 1977, and was designed to take advantage of section 23 F of the Income Tax Assessment Act,⁷⁰ by providing a tax shelter for principals of firms whilst at the same time creating retirement funds.

The function of the company is to provide management and administration services to the firm concerned, and to run the non-professional, non-chargable activities of the practice. It would normally be employed to maintain the office, the library, machinery and allocation of incoming work to the partnership staff. Overall, it is engaged by the practice as supervisor of non-professional activities and the staff performing such work.

In carrying out its functions, the service company employs the principals of the firm, pursuant to contracts of service or employment with each, and charges the practice for the services rendered by them in terms of a service contract entered into between the firm and the company.

In addition to paying the partners a salary for the time spent performing service company duties, it also contributes to an employer subsidised superannuation scheme to the maximum possible extent - generally ten per cent of salary;⁷¹ pays the scheme administration costs;⁷² group life insurance cover⁷³; and Accident Compensation levies.⁷⁴ All the costs of the company are charged to the partnership, and claimed as "costs incurred in the production of assessable income", pursuant to section 104 of the Income Act 1976 by the partnership.

As noted in Part 5, for this concept to work for all members of the company, it is necessary to have a minimum of six shareholders⁷⁵. Whilst this has posed no problem in firms with six or more partners, it has created a problem in respect of sole practitioners and smaller firms and has resulted in the development of the multi-practice service company, in which several sole practitioners and or "small" firms have banded together under the umbrella of one service company. This device, designed to circumvent the provision of section 150 of the Income Tax Act, 1976, as to the definition of an "employee-shareholder", has met with its own particular opposition which will be discussed in paragraph...

4.2 The Service Company in Operation

As noted, the primary objective in incorporating a service company is to provide a vehicle which will employ practitioners, thereby deeming them "employees" albeit part time employees, but nevertheless giving them the

status necessary to gain some measure of tax sheltered superannuation. Inland Revenue to the proposed salary level of each partner, and in so doing to justify the As company superannuation contributions to an employee subsidised superannuation scheme and the tax deductibility in respect thereof are geared to the employees' salaries, it is first necessary to determine the salary each partner will receive from the service company in his capacity as a part time employee. This is determined by establishing the time each partner spends, upon a per annum basis, engaged in those activities henceforth to be deemed service company activities - that is, administrative, non-professional activities. As this may vary considerably from partner to partner within one firm, especially where one acts as practice manager, or administrative partner, the administrative time is averaged across all of the partners to give a global figure. This practice is accepted by the Commissioner of Inland Revenue. The author's experience is that in legal and accounting practices partners spend an average of between 28 per cent and 33 per cent of their time on administrative tasks. Once the time component is established, it is then expressed in dollar terms by reference to each partner's prior year's assessable income. That is to say if a partner earned assessable income of \$60,000 in the prior year, and it was established that 33 1/3 per cent of his time was spent upon administrative activities, then his service company salary would be \$20,000.

It is of course necessary to obtain the consent of the Commissioner of Inland Revenue to the proposed salary level of each partner, and in so doing to justify the time component claimed. It has become the accepted practice to submit to the Commissioner a summary of the firm's time recording results for the prior year's activities. However over the last few months a pattern has emerged in respect of various professional groups, so this is becoming less important. Nevertheless, the Commissioner still requires supporting evidence in each case.

Once service company salary levels have been determined, and the service company has been incorporated, each partner enters into a contract of service with the service company to the intent that as an employee of that company he will perform the stipulated administrative tasks of the practice. Additionally a contract for the supply of and completion of the firm's administrative requirements is executed between the firm and the service company.

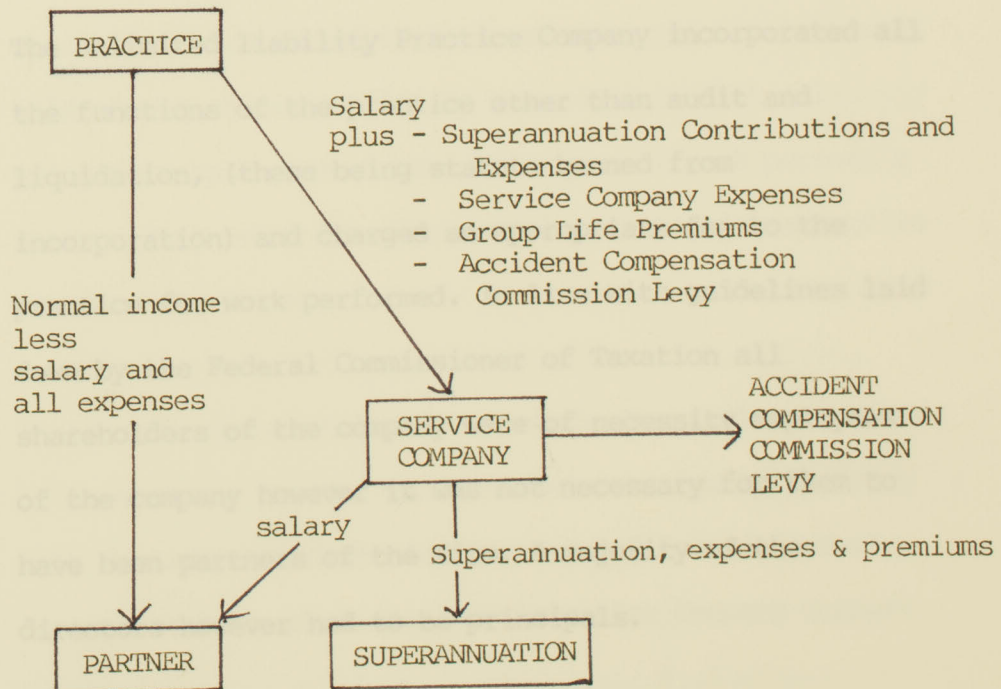
From a monetary point of view, the net result of this convoluted structure is that instead of a partner receiving from the practice, assessable income of \$60,000; paying \$28,539 of income tax⁷⁶, and thereby netting a disposable income of \$31,461, he would receive a disposable income of \$30,663, pay \$1,549 less tax and have accumulated \$2,000 in his superannuation accumulation account⁷⁷.

(i) Partner of firm	Gross	Tax	Net Income	Superannuation
	\$60,000	\$28,539	\$31,461	Nil

(ii) Service company employee and partner of firm	Gross	Tax	Net Income	Superannuation
	\$60,000	\$26,990	\$30,663	\$2,000

This means that by a partner becoming a service company employee he receives \$798 less in disposable income, but pays \$1,549 less tax and accumulates \$2,000 in his superannuation fund.

As already noted, this is achieved by having the service company charge the firm the salaries paid to the partners; the superannuation contributions; superannuation fund expenses; the service company expenses; group life insurance premiums and Accident Compensation levies - all of which are tax deductible expenses.⁷⁸



It should be noted that the Commissioner of Inland Revenue exercises his discretion pursuant to section 6(2) of the Income Tax Act 1976, thereby relieving the partners of the necessity of paying P.A.Y.E. on their service company salaries, they being deemed provisional tax payers.

4.3 Development of the Service Company

By early 1977 there had evolved in Australia three means of structuring accountancy practices in the majority of the states:

- i) full incorporation as an unlimited liability company, excepting the audit and liquidation functions, - known as the Practice Company;
- ii) partial incorporation relating only to administrative and non-professional activities in limited liability form - known as the Administration Company;⁷⁹ and
- iii) partnership, involving no form of incorporation.

The unlimited liability Practice Company incorporated all the functions of the practice other than audit and liquidation, (these being statute banned from incorporation) and charged an appropriate fee to the practice for work performed. In line with guidelines laid down by the Federal Commissioner of Taxation all shareholders of the company were of necessity employees of the company however it was not necessary for them to have been partners of the firm. A majority of the directors however had to be principals.

For reasons unknown, it is understood that few Accountancy firms availed themselves of the right to form Practice Companies, notwithstanding that salary levels would in most cases have been higher than in the case of Administration Companies and therefore a greater tax shelter and higher superannuation benefits would have been available.

By contrast, the legal fraternity in Australia was not offered by the Australian Law Society the opportunity of full incorporation via the medium of the Practice Company at all. They were limited to the Administration Company.

By Memoranda dated 9th March and 8th August 1978, the New South Wales Law Society established the conditions and requirements for the formation of Administration Companies by its members, and the conditions laid down strongly indicate that they were formulated after consultation with the Income Tax Department. Amongst other things, the companies were not to be used as income splitting devices, and to that end only principals could hold shares. Additionally, it was required that all principals hold shares, the proportion of each partner's shareholding being broadly proportional to his respective partnership interest.

In 1980 the Taxation Committee of the New Zealand Society of Accountants began a concentrated campaign of lobbying both Parliament and the Commissioner of Inland Revenue for approval to adopt the Administration Company concept

- known here as the Service Company - in New Zealand.

The New Zealand Society of Accountants developed a rigid set of guidelines for its members and subsequently won official approval in October 1981. On the 28th February 1982 the New Zealand Society of Accountants published its guidelines, and shortly thereafter notified its membership of the inclusion of a new clause inserted in its code of ethics embodying its earlier guidelines.⁸⁰

A mandatory form of Articles of Association, Memorandum of Association and Contract of Service between the firm and the Service Company was required. The consent of the New Zealand Society of Accountants was required to the company's formation; its name and membership; its style of letterhead; the proposed employee remuneration; the basis of fee setting; time spent on company work; and approval of the superannuation scheme from the Government Actuary. It was a specific requirement that only Society members in public practice could be directors and/or shareholders, and that the fees charged to the firm would be no greater than its operating expenses - taking into account, salaries, scheme administration costs, group life insurance cover, company administration expenses and Accident Compensation Levies. In effect the company was to be a zero profit company incapable of acting as an income splitting device. Its sole purpose was to be the provision of superannuation and associated benefits.

Naturally, once the accountants had obtained approval from the Inland Revenue and the blessing of their Society to proceed with the Service Company concept, the legal fraternity began to show an interest in following suit.

The attitude of the New Zealand Law Society was considerably more relaxed than that of their accounting brethren, advising interested firms and fund managers that it was of no concern to the Society what domestic superannuation planning a firm undertook, so long as any scheme undertaken complied with the Society's Code of Ethics and was accepted by the Inland Revenue Department. They stated that the formation of a superannuation company as such was not prohibited by the Code of Ethics.⁸¹ This stance was formalised by an article headed "Super service Companies not prohibited"⁸² in September 1984 in which the Society reiterated that the Code of Ethics did not prohibit the formation of such companies, and that a letter advising as such had been forwarded to the Inland Revenue Department.

4.4 The Stance of the Commissioner

The Commissioner of Inland Revenue has advised professional bodies that he:⁸³

Accepts in principle the argument that service companies, formed to carry out the administrative activities of a professional partnership's business, should be able to claim a taxation deduction under section 150 of the Income Act 1976 in respect of superannuation payments made on behalf of their principals.

Furthermore, the Department of Inland Revenue would expect to find that the gross income of the service company would be no greater than necessary to meet the administrative costs and salaries, and the superannuation contributions.

The Commissioner has also advised that in each case where a firm wishes to establish a service company the following should be submitted;

- i) Copies of the memorandum and articles.
- ii) A copy of the contract between the firm and the service company.
- iii) A statement from the firm giving such information as is necessary to permit a full understanding of what services will be provided by the company and what basis is used to set the fees for these services.
- iv) Details of the principals and employees in the firm who will be employed by the company in providing the services and the time they will spend on the company's work.
- v) Details of the way in which the remuneration of these people is set and the relationship between their income from the company and the firm.
- vi) Details of the approval of the superannuation scheme by the Government Actuary, and of the contributions to the scheme.

The questions raised in the items i-iv, are apparently:⁸⁴

...intended to elicit information that will show that remuneration of the professional partners who are also employees of the company is realistic in relation to their service to the company in providing the skills required to enable the company to carry out its administrative responsibilities for the partnership.

The Department needs to be satisfied that there is not a tax avoiding income splitting arrangement, and that the only tax advantage being gained is the deduction of the appropriate superannuation contributions; also that the remuneration and superannuation contributions are realistic in relation to the overall activities and income of the professional partners.

Provided the Commissioner is satisfied with the material submitted to him, his consent to the deduction of the superannuation contributions⁸⁵ and all associated expenses⁸⁶ will be granted. Additionally, upon application being made, he will generally consent to the service company salaries not being subjected to P.A.Y.E..⁸⁷

4.5 The Problem of the Multi-Practice Company

As stated in paragraph... the taxation consequence of the Government Actuary's classification of any superannuation scheme is of vital importance. Where he refuses to accept and classify a scheme or gives it an adverse classification, there can be no deductibility in respect of employer contributions.⁸⁸

As a natural progression from the concept of forming a Service Company for a partnership, it had become common practice for the insurance companies and superannuation fund managers to form on behalf of smaller firms,⁸⁹ what have become known as Multi Practice Service Companies. As the Income Tax Act 1976⁹⁰ denies

deductibility in respect of employer contributions where an employee holds twenty per cent or more of the shares in the company, it had been seen as expedient to band several practices together, each with less than six partners, to avoid this provision. The basic rationale behind this move was of course to form a Service Company catering to a number of small practitioners, and thus give them, as a group, an umbrella company for superannuation purposes. Whilst the Commissioner of Inland Revenue accepted the multi-practice service company without hesitation, the Government Actuary, Mr Kelvin Prisk, did not. In fact he extended his discomfort with the multi-practice concept to the single practice service company and consequently decided to deny approval to any Superannuation Scheme submitted for classification and approval in respect of a service company. To that end he wrote to the New Zealand Law Society in late, 1984, stating as follows:⁹¹

As you are aware I have been uncomfortable about the concept of service companies for the provision of superannuation benefits for various professional groups.

While I have sympathy with the aims of the arrangements, it is my duty to administer the Superannuation Schemes Act as it exists.

The Superannuation Schemes Act 1976 defines employee as "any person who is engaged to work or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical

or professional work, or otherwise but does not include any person who would be a shareholder employee within the meaning of section 150(1) (d) of the Income Tax Act 1976 if the expression '20 per cent' was omitted from subparagraph (i) and (ii) of that provision and the expression '50 per cent' was substituted in each case."

My understanding of the law is that a contract of service can not exist between a partner and the partnership and accordingly, the partners of a partnership cannot participate in an employee superannuation scheme.

It is suggested that since the partners have a contract of service with the service company (for part of their activities), then they are employees of the service company and therefore qualify for superannuation and other benefits that are made available to employees.

It is my conclusion that the 'contract of service' between the partner and the service company is merely a reiteration of the 'contract of services' that exists between the service company and the partnership and accordingly, the partner is not an employee within the meaning of the Superannuation Schemes Act.

Where a trust deed expressly provides that a partner shall be eligible to join a superannuation scheme, I will not grant approval to that scheme as either an employee pension superannuation scheme or an employee lump sum superannuation scheme as the case may be. In circumstances where the definition of eligible employees is vague, I will have little option but to grant approval but in these circumstances the onus is on the trustees not to admit partners since they are not employees.

It is my intention to bring this matter to the attention of the Government with a view to reassessing the position of persons not eligible for membership of employee superannuation schemes.

The essence of the Government Actuary's argument was that a partner could not be a part time employee of the service company, and therefore could not be an "employee" within the meaning of the Superannuation Schemes Act 1976.

The term "employee" is defined in section 2 of the Superannuation Schemes Act 1976 as meaning, ... any person who is engaged to work or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical or professional work, or otherwise...

It is submitted that the terms of this definition are prima facie satisfied where a member of a professional partnership enters into a contract of service in respect of the activities to be performed pursuant to that

contract, particularly as the terms of the definition extend to part time employment, and given further that the contract of service between each partner and the superannuation service company would be a real and not a sham contract, imposing genuine rights and obligations on the parties to it.⁹²

There appears to be no reason, either in partnership law or otherwise for casting doubts upon the validity of such a proposition.

In terms of the law of partnership there appears to be no legal authority which assists in resolving whether a partner may also be a part time employee of a company established by, or otherwise related to, the partnership of which he is a member. It is submitted that the explanation for that apparent absence of authority is not, however, that there is any legal impediment to a partner entering into such a contract, but rather that his ability to do so is so self evident as not to have ever given rise to litigation. What the authorities, and current practice do establish is that a partner is entitled to enter into a contract of service with a company or other employer unrelated to the partnerships. Naturally the appropriate consents to that employment must first be obtained from the other partners,⁹³ and in carrying out his employment obligations the partner is subject to a variety of constraints to ensure that no conflict arises between his duty to his partners and the

performance of his contract of service. But it is suggested that there is no real doubt at all that as a general proposition a partner is not disqualified from occupying the position of both partner and employee of an unrelated company. Given this, it would be a remarkable proposition to suggest that while a partner is able to enter into a contract of service with an unrelated company, he may not do so with a company formed by or associated with the partnership of which he is a member. Such a proposition would deny the doctrine of the corporate personality. Accordingly, one must conclude that partnership law imposes no obstacle to a partner occupying the dual status of both principal and employee, so long as both a partnership and a company are in existence.

It was also argued by the Government Actuary that the contract of service between the partner and the service company was merely a reiteration of the contract for services that existed between the service company and the partnership, and accordingly the partner could not be an "employee" within the meaning of the Superannuation Schemes Act 1976.

It is a little difficult to grasp the precise meaning intended by the Government Actuary in this contention. If no more was intended than the observation that the service company could only perform its contract with the partnership by entering into a series of specific contracts with its own employees, each of whom would discharge a part of its overall contractual burden, then he was obviously correct.

It is assumed however that his contention was intended to go further than this, to suggest that both the role and the contractual obligations of the service company could on some basis be ignored and accordingly the two distinct contracts would in legal contemplation be entered into between the partnership and the individual partners and thus be invalid.

In effect, the Government Actuary's contention was that the whole arrangement was a sham, which, given the facts was an argument that could not be sustained.

The service company was incorporated in accordance with the provisions of the Companies Act 1955; both the contract for services and the contracts of service were executed in accordance with all formal contractual pre-requisites; and those contracts were valid and effective contracts imposing genuine rights and obligations. Accordingly, such an arrangement could not be considered a sham.⁹⁴

In February of 1985, the Government Actuary announced that he had modified his stance, stating that as his earlier position had been arguable he had turned his attention to other issues, "... that the Courts have considered in examining the relationship of employment".⁹⁵ In so doing he said he would accept the superannuation service company which provided services for only one firm i.e., the "in-house" service company, but that he would not accept those service companies that had been established to service several practices - the multi-practice service companies.

The essence of the Government Actuary's argument was that in the multi-practice situation the test of whether an employment relationship existed was whether the person said to be an employee was " ...an integral part of the business..."⁹⁶ of the company. Whilst he would accept this test as being satisfied in the in-house service company situation, he would not in the case of a multi-practice service company.

It is suggested that the Government Actuary's contention is not compelling, especially when one considers his obviously vague distinction between the multi-practice and in-house service companies; that he could consider his "integral" test having being satisfied in the case of the latter, but not in the former. His criterion does not provide a satisfactory basis for distinguishing between the two, as it does not follow that the test is satisfied simply by virtue of the sole-practice basis of the company any more than it follows that it is not satisfied in a multi-practice case simply because of that multi-practice feature. It is a purely arbitrary distinction to draw.

The "integral" criterion is only one of the tests relevant to the issue of whether an employment relationship exists and recent authorities have stressed that it is the intention of the parties, as manifest in the written or other agreements between them, which is crucial.⁹⁷ In recent Privy Council decisions it has been established that the terms of any written contract, particularly in so far as they relate specifically to the issue of the status of the "employee", is the single most

Beyond doubt contracts of employment will be entered into between the superannuation service company and each of the members, and beyond doubt these contracts will be expressed in "employee" terms. It is equally beyond doubt that the contracts of service are intended to create the binding legal rights and obligations which they give the appearance of creating and therefore cannot be considered a sham.⁹⁸

The question as to whether a member of a multi-practice service company is an "employee" for the purpose of the Superannuation Schemes Act 1976 is now the subject of litigation, the A.M.P. Society on behalf of such a multi-practice company challenging the Government Actuary's decision in the High Court. It is understood that a fixture date for bringing on the action is imminent.

4.6 Conclusion

Members of firms with six or more partners may currently be members of employer subsidised superannuation schemes via the medium of the service company, and accordingly gain some element of the tax shelter available to those employed in the corporate environment. By contrast, due to an arbitrary decision of the Government Actuary, those practising on their own account or in smaller firms cannot; an anomaly due for resolution in the near future. Regardless of whether this pending litigation is successful in favour of the small practitioner or not, the fact remains that the service company concept is a clumsy device which is expensive and time consuming to

create, and only permits approximately one-third of the practitioner's assessable income to be taken into account for superannuation contribution purposes. Thus even the service company concept does not place the professional on the same footing as his corporate brethren in the public section. In terms of superannuation the anomaly still remains, to be cured either by repealing the requirement that an employer subsidised superannuation scheme member be an "employee" or by permitting all professionals to fully incorporate.

what was suggested in paragraph 3.3.3. as being an illusory limit to his liability - one which due to personally guaranteed indebtedness and personal liability for professional negligence would largely defeat the purpose of incorporating with limited liability. The only possible advantage could be that in the event of the company being sued, the member could only be liable in a winding up to the extent of his capital. This however does not recognize the fact that few professional people would be prepared to stand by and permit their investment to be lost, nor does it recognize the probability of members being required to hold compulsory professional indemnity cover and/or give blanket personal guarantees.

Accordingly it is suggested that the limited company has no advantage over the unlimited company and in fact the former is at quite a disadvantage to the latter in administrative terms.

Part 5 THE UNLIMITED COMPANY

5.1 Introduction

It is suggested that the unlimited liability company is the form of incorporation that is most likely to be adopted by the legal profession as being appropriate to its needs.

The limited company offers a member what was suggested in paragraph 3.3.3. as being an illusory limit to his liability - one which due to personally guaranteed indebtedness and personal liability for professional negligence would largely defeat the purpose of incorporating with limited liability. The only possibly advantage could be that in the event of the company being sued, the member could only be liable in a winding up to the extent of his capital. This however does not recognise the fact that few professional people would be prepared to stand by and permit their investment to be lost, nor does it recognise the probability of members being required to hold compulsory professional indemnity cover and/or give blanket personal guarantees.

Accordingly it is suggested that the limited company has no advantage over the unlimited company and in fact the former is at quite a disadvantage to the latter in administrative terms.

As is briefly discussed in paragraph 3.3.2 and in more depth in this chapter an unlimited company may reduce or increase its capital without the necessity of a court order. Additionally, given this capability of altering its capital, it may create or surrender and cancel shares with comparative ease, thus accomodating with ease the addition or deletion of members.

By contrast, a reduction of capital of a limited company requires a court order, and accordingly the coming and going of members could only be achieved by sale of shares.

5.2 The Unlimited Company's Structure

Section 13 of the Companies Act 1955, provides

- (1) Any seven or more persons associated for any lawful purpose may ... form an incorporated company, with or without limited liability.
- (2) Such a company may be ...
 - ... (c) A company not having any limit on the liability of its members (in this Act termed "an unlimited company".)

Unlimited liability however is not restricted to public companies, section 20 of the Companies Amendment Act (No. 2) 1983 amended section 353(1) of the principal Act so as to read;

Notwithstanding anything in this Act, it shall be lawful for any number of persons not exceeding 25 associated for any lawful purpose ... to form a private company having its capital divided into shares, and having the liability of its members ... unlimited.

It is worthy of note that a private unlimited liability company is required to have ... "its capital divided into shares ..." and further pursuant to section 356(2) that share capital must be subscribed for.

A public unlimited company formed pursuant to section 13 of the Act may be incorporated either with or without a share capital, however, where it does have shares, as it is not bound by section 356(2) that share capital may be partly unsubscribed.

Where the company does have a share capital, it must be stated in the Articles,⁹⁹ rather than in the Memorandum.¹⁰⁰ If it has not, then the number of members¹⁰¹ with which it proposes to be formed must be stated instead,¹⁰² and any subsequent increases notified to the Registrar within 15 days, and recorded by him.¹⁰³

The requirement that there must be stated in the Memorandum, the name of the company followed by the expression "limited", does not apply to an unlimited company.¹⁰⁴

The form of the Memorandum and the Articles of an unlimited liability company having a share capital is to be in accordance with, "... or as near thereto as circumstances ..." ¹⁰⁵ permit to those set out in Table E of the Third Schedule to the Act. ¹⁰⁶ The prescribed form of Memorandum is similar to that set out in Table B of that schedule for an ordinary limited liability company, except that the statements that the liability of the members is limited, and that the share capital is a certain amount, are omitted. The incidental and ancillary objects and powers set out in the Second Schedule, to the extent that they are not modified or excluded expressly, are applicable, subject of course to the exceptions contained in section 16(1).

The model Articles set out in Table E of the Third Schedule to the Act does include a statement of share capital, and also a statement of the number of members with which the company proposes to be registered, with power in the directors to register an increase from time to time. ¹⁰⁷ With the exception of Articles 40 to 47, which deal with the conversion of shares into stock, and with an alteration of capital, Table A is deemed to be incorporated.

The Articles also empower the company to reduce its share capital in anyway, by special resolution. It has long been accepted that as such power is contained in an unlimited company's Articles, the consent of the Court, as is otherwise required by section 75 is unnecessary. ¹⁰⁸

Whilst the registration of the Articles of Association is optional in the case of a company limited by shares, it is compulsory for an unlimited company. The Articles must be registered with the Memorandum and according to section 20 "... signed by the subscribers of the memorandum ...".

5.2.1 Liability of members:

Although any shareholder is said to be liable to the full extent of his assets, the nature of his liability differs from that of a member of a partnership. As a partner, he would be liable direct to the creditors of the partnership.¹⁰⁹ On the other hand, as a member of an unlimited company still in business, his only liability is to the company. He must pay calls to the full nominal amount¹¹⁰ of any shares he has in it, but he is not liable to creditors in respect of the debts of the company. The only way in which his liability can arise is by demand of the liquidator after the company has been ordered to be wound up.¹¹¹

A contributory may set off against calls made before winding up, debts due by the company to him otherwise than in his capacity as a member,¹¹² however, a set off against calls made subsequent to the winding up is not permitted.¹¹³

Calls must be made on members for the capital unpaid on their shares (if any) in the first place, and if this yields insufficient to discharge the company's liabilities further calls must be made in proportion

to the nominal value of each contributory's shares,
of if the company has no share capital, equally upon
all the contributories¹¹⁴

If in such a case, the existing members are unable to
meet the debts of the company,¹¹⁵ any person who had
been a member within the previous year¹¹⁶ is liable to
contribute, except to the extent that the debts in
question were contracted after he ceased to be a
member.¹¹⁷

5.2.2 Reduction of share capital

As has been noted, the share capital, if any of an
unlimited company, may be reduced without resort to the
courts. This is possible, as, if there is a share
capital, it is required to be stated in the
Articles.¹¹⁸ Unlike the Memorandum,¹¹⁹ a company's
Articles can be amended by a special resolution - in the
case of a private unlimited company, by entry in the
minute book,¹²⁰ and in the case of a public unlimited
company by a special resolution passed at a general
meeting convened pursuant to section 145. Moreover, the
provision requiring sanction of the Court to any
reduction,¹²¹ is, in express terms, confined to
companies limited by shares or by guarantee and having a
share capital.¹²² Notice of any special resolution must
be given to the Registrar within fifteen days.¹²³

Thus, in this respect, the unlimited corporate form confers the freedom of a partnership on the professional practice that requires the corporate identity, and the associated taxation and fiscal advantages.

5.2.3 Purchase by company of its own shares:

It is submitted that the logic behind an unlimited company's ability to reduce its share capital can be extended a stage further.

The principle that a company may not purchase its own shares was established by the House of Lords in Trevor v. Whitworth,¹²⁴ Lord MacNaghten considering that to allow such purchases would, inter alia, be inconsistent with the conditions upon which "Parliament had granted the privilege of limited liability".¹²⁵ It was recognised that there are clear dangers in allowing a company to buy its own shares as in doing so it parts with consideration without having received a tangible benefit in return. The dominant policy behind the rule is thus one of creditor protection, since the objective is to prevent the dissipation of the fund to which a company's creditors look for payment.

The rule in Trevor v. Whitworth¹²⁶ is reinforced and expanded by section 62 of the Companies Act 1955 which provides:

... it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security, or otherwise, any financial assistance for the purpose

of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company ...

It is a natural extension of the Trevor v. Whitworth¹²⁷ rule as to the unauthorised disbursement of a company's assets that a company should be prohibited from assisting financially any other person to acquire its shares. In such a case, the company parts outright with the consideration for the purchase, thereby reducing its capital, to the prejudice of the interests of its own minority shareholders and its creditors. However, whilst such a reduction of capital is unlawful for a company limited by shares, such is not the case for an unlimited company. As was noted by Vaughan Williams J,¹²⁸ ... there is nothing in the words or in the spirit of the Acts of Parliament which prevents an unlimited company being associated on the terms that members may withdraw in the mode which it is provided by the particular memorandum of association or articles. It seems to me that if one limits the matter in that way, the creditors would have nothing to complain of.

In citing the decision of Vaughan William J. as authority for the proposition that an unlimited company may acquire any of its own shares if authorised to do so by its articles, Pennington¹²⁹ explains the reason for the relaxation of the normal prohibition on a company acquiring its own shares in the following terms:¹³⁰

... the members of an unlimited company are liable to satisfy its debts without limit, so that a reduction in the company's unpaid capital or a diminution of its assets resulting from the acquisition of the shares merely operates to increase the personal liability of its members.

Similar sentiments are echoed in Halsbury,¹³¹ it providing:

An unlimited company which has power to do so under its articles may accept a surrender of shares on the terms of the member receiving back the amount paid up on them.

A purchase of shares by an unlimited company, must, it is submitted, be treated as any other reduction in capital and the appropriate special resolution passed. In the case of private unlimited company by entry in the minute book,¹³² and in the case of a public unlimited company by special resolution passed at a general meeting.¹³³

5.2.4 Public or Private - the exempt private unlimited company:

Prior to the formation of an unlimited liability company, a legal partnership is going to be faced with several important questions regarding the structure of the proposed company;

1. a private, or a public company?
2. a share capital, or no share capital?
3. how to transfer interests upon joining or leaving the company?

A private company, and, in particular, an exempt private company does have distinct advantages over being classified as a public company.

A private company is defined to mean one that has a minimum of two members¹³⁴ and a maximum of twenty-five,¹³⁵ whilst, predictably an exempt private company, is one that is not included within the meaning of the expression, "non-exempt private company".¹³⁶

That expression is defined to include any private company that is indebted to any person in respect of any loan to which the Securities Act 1978 applies; is a subsidiary of a company incorporated outside of New Zealand, or, is one in which twenty-five per cent or more of the voting power is held offshore.¹³⁷

It is difficult to imagine an incorporated law firm having an offshore shareholding or being a subsidiary of an offshore company, and also to imagine such a company becoming indebted in respect of a loan or deposit to which the Securities Act 1978 applies.

An exempt private company has the advantage of not having to file with the Registrar of Companies a copy of the company's balance sheet, report of the auditors and of the company's directors as required of other companies by section 133 of the Act¹³⁸. Likewise it is unnecessary to appoint an auditor as is otherwise required by section 163, where an appropriate resolution is passed.¹³⁹

These provisions in effect mean that the financial affairs and status of the "firm" or corporate practice are not filed at the Companies Office, and therefore, remain private. By comparison, a non-exempt private company that has issued a prospectus in respect of debt or participatory securities¹⁴⁰ is required to appoint an auditor to make the report necessary under the Securities Act.¹⁴¹ In addition, a non-exempt private company along with public companies must file with the Registrar those items required by section 133 of the Companies Act 1955 - namely, the balance sheet, auditors' report and directors' report. Whilst financial confidentiality is not prerequisite to the success of an incorporated legal practice, one anticipates that practitioners will endeavour to structure their affairs in order to qualify as exempt private companies whenever possible.

From an administrative point of view, the second principal advantage of the private company is that provided by section 362 of the Companies Act 1955 - that resolutions may be passed without the need for a formal meeting. This provision permits any resolution to be passed by means of entry in the company's minute book, signed by at least three quarters of the members entitled to vote on that resolution, and in so doing makes administration considerably easier by doing away with the necessity of formal notice of a meeting and then actually holding the meeting. Section 145 of the Act requires that for an extraordinary or special resolution to be passed by a public company, a majority of three quarters is required.

5.2.5 In such a case as that of a shareholder in an unlimited company selling his shares back to the company upon retirement, if the company were public, a meeting would have to be convened pursuant to section 145, and a resolution authorising the appropriate reduction of capital passed by a three fourths majority. It would be physically considerably easier to pass the appropriate resolution by entry in the minute book, and then circulate the resolution for signature by the members.

Other advantages enjoyed by a private company are less obvious - the restrictions on the commencement of business and the need for holding a statutory meeting do not apply.¹⁴²

Section 33 of the Companies Act, 1955 provides that, For many firms wishing to incorporate, the choice between the private or public company may not in reality exist. A majority of the larger firms in the country have in excess of twenty five partners already, and for a partner to maintain his rights and privileges vis-a-vis his fellow partners, he along with those fellow partners is going to want a share and a vote in order to protect those privileges. Accordingly a share per partner/member will disqualify the larger firms from classification as private companies pursuant to section 353(1). Although several partners could hold shares jointly, thus qualifying as a single member,¹⁴³ it is submitted that this would likely head to undue complexity and complication with the admission of new members and the retirement or demise of the old.

5.2.5 Share capital - transfers and surrenders:

Unlimited public companies may, pursuant to section 21, be incorporated either with or without a share capital whilst a private unlimited company is required by section 353(1) to have a share capital. Whether an unlimited public legal company should choose to incorporate with a share capital or without, will be influenced by such questions, as how membership is to be transferred, how membership is going to be restricted and the value, if any, to be ascribed to membership. It is submitted that, bearing such questions in mind, the obvious choice must be a company with share capital.

Section 82 of the Companies Act 1955 provides that,

"The shares or other interest of any member in a company shall be personal estate, transferable in the manner provided by the articles of the company, and shall not be of the nature of real estate."

Whilst a provision in a company's Articles which purports to prohibit altogether a transfer of shares is illegal and void,¹⁴⁴ the validity of a restriction upon transfer is clearly established.¹⁴⁵

It is submitted that not only would a legal company want to restrict membership to practitioners qualified in terms of section 55 of the Law Practitioners Act 1982, but also to those practitioners invited by the company to become members.

As is discussed in Part 6, that a member be a qualified practitioner is certain to be a New Zealand Law Society requirement, whilst control of who is to be invited to join the company or to whom existing members may dispose of their interests, is a right available to most companies exercising the powers conferred by the Articles.

5.3 Conclusion

The power vested in the directors by the Articles, to refuse to register a transfer of shares is often so widely drawn that the only limitation upon it is that implicit in law, ie that it must be exercised bona fide in what the directors consider to be the interests of the company.¹⁴⁶ That they have not acted bona fide is to be shown by those who attack their decision.¹⁴⁷

In addition to the unlimited law company imposing via its Articles restrictions upon the right to transfer shares, the Articles should also empower the company to accept a surrender of shares. As was noted earlier, such an ability would permit a maintenance of the status quo in respect of such matters as profit sharing and control between the shareholders in the event of one of their number dying or retiring from the practice. In such a case the shares held by that deceased or retiring shareholder, instead of devolving upon his estate in the event of death or being sold upon retirement, would be surrendered to the company and cancelled and the capital reduced accordingly; the existing shareholders' rights and obligations in relation to each other remaining undisturbed.

In the event of a practitioner being invited into the company, the capital would be increased by the value of the shares to be allocated to the incoming shareholder. Such shares could be allocated at par or at a premium as discussed in Part 3 and could be paid in full or in part.

5.3 Conclusion

It is submitted that in many respects, the unlimited liability legal company would in practical terms be little different from the legal partnership today. Whilst the incorporated lawyer would have the advantage of tax sheltered superannuation and other tax and fiscal benefits and also the extent of his personal liability would be limited unless and until the company was wound up, the day to day administration of the practice would not be a lot different.

Part 6 IMPEDIMENTS TO INCORPORATION

6.1 The Law Practitioners Act 1982

The conduct of a lawyer's practice is governed by the provisions of the Law Practitioners Act 1982 which provides:¹⁴⁸

Every person commits an offence against this Act who, not being enrolled under this Act, -

- (a) Acts as a solicitor; or
- (b) Holds himself out as being qualified to act as a solicitor; or
- (c) Takes or uses any name, title, addition, or description implying or likely to lead any person to believe that he is qualified to act as a solicitor; ...

Whilst it is patently obvious that this provision was designed to prevent unqualified persons acting as, or holding themselves out as, solicitors,¹⁴⁹ it is submitted that in its present form it theoretically prohibits the practice of law in corporate form. Further that, as such practice is not a "lawful purpose" in terms of the Companies Act 1955,¹⁵⁰ any such "company" is rendered an illegal or unlawful association.

This rather specious and technical objection to the incorporation of law firms finds its roots in that long line of decisions that have long settled as law the proposition that a company incorporated in accordance with the Companies Act 1955 is a legal entity distinct

from the personalities of its members. "It is a legal persona just as much as an individual" noted Cave J.,¹⁵¹ but, as stated by Lord Macnaghten:¹⁵²

The company is at law a different person altogether from the subscribers to the Memorandum and, although it may be that after incorporation the business is precisely the same as it was before ..., the company is not in law the agent of the subscribers or trustee for them.

The point is that once a company is legally incorporated:¹⁵³

... it must be treated like any other independent person with rights and liabilities appropriate to itself.

Accepting that a company is legally a person, and in that light reading section 64(1) of the Law Practitioners Act 1982, the question becomes one of whether or not a company can be duly enrolled as a solicitor pursuant to that section.

In Law Society v. United Service Bureau Limited,¹⁵⁴ the House of Lords held that a company could not be qualified to act as a solicitor, section 46 of the Solicitors Act 1932 (UK) providing:

... any person not having in force a practising certificate, who wilfully pretends to be ... qualified ... to act as a solicitor [shall be liable to a penalty] ...

It was decided by the court that as well as the section using the expression "wilfully" - thereby introducing an element of mens rea, an element of an offence of which a company cannot be capable - the words themselves were only capable of applying to a natural person.

Accordingly, a company was incapable of being qualified as a solicitor.

Subsequent to that decision the Solicitors Act 1932 (UK) was amended for the avoidance of doubt.

It is suggested that section 64(1) of the Law Practitioners Act 1982 goes considerably further than did section 46 of the Solicitors Act 1932 (UK) and, although the language of the former does utilise language appropriate to the natural as opposed to the artificial "person", that in this case one is not exclusive of the other. Accordingly, it is submitted that a company being a person, not being enrolled as a solicitor, commits an offence if it does any of those things listed in subparagraphs (a), (b), or (c) of section 61(1).

For an offence to be committed pursuant to section 64 of the Law Practitioners Act 1982, it is first necessary that the "person" acts as a solicitor, holds himself out as being qualified to act as a solicitor or leads a person to believe he is qualified to act as a solicitor. That a company cannot be "qualified" to act as a solicitor is a matter of fact - section 44 of the Act requiring that for a person to be qualified certain examinations must first be passed.

It is submitted a client of an incorporated legal practice would form his contract for the provision of legal services with the company, not with the individual solicitor and in this context it is the company holding itself out, not the solicitor. Additionally it is contended that the hanging of a corporate practice's shingle or plate, or the use of a letterhead which indicated that the practice was being conducted as a company, would be more than sufficient to infringe against both subsections (1)(b) and (1)(c) of section 64. Such notification would make it quite plain that legal services were being offered to the public generally. In Business Consultants Ltd. v. Butler¹⁵⁵ it was held by the High Court that advertising signs around the defendant company's premises amounted to a holding out to the public of accounting services.

The contrary argument is of course that in considering a question of ethics, the substance rather than the form should be considered. From such a point of view it then becomes difficult to see how any objection could be taken to a company 'practising' law, when no objection is taken to the practice of law by its members. After all, a company, being an "...artificial person composed of natural persons ..." ¹⁵⁶ is only able to operate and conduct its business through its organs and it cannot realistically be said that the company itself will practise law. The company will in reality employ the solicitors who will in turn give legal advice and generally carry out the duties required of a legal practitioner.

Whilst such an argument is a logical and attractive one, it unfortunately flies in the face of that line of legal reasoning that developed the concept of the company being a separate and a distinct persona from its members. The so-called "corporate veil" that resulted from the cases following Salomon v. Salomon & Co. Limited¹⁵⁷ is rarely lifted and, in that minority of cases where the courts have disregarded it, it has rarely been to benefit other than aggrieved third parties. Accordingly one has little cause to believe that the courts would be willing to assist a corporate legal practice in this instance; a fact that is perhaps made all the more harsh when one considers the positions of other professions and trades. For example, under existing law no-one is entitled to practice on his own account as a real estate agent, motor mechanic or electrical engineer without having first passed the prerequisite examinations and having been approved for the purpose. It appears that no objection has ever been taken that companies formed for these purposes are incapable of holding the necessary licences, permits or diplomas. Why then should the legal profession be prejudiced?

One must accept that the stronger case, and hence the better view, is that a corporate law practice would infringe the provisions of section 64 (1) of the Law Practitioners Act if it acted as a solicitor,¹⁵⁸ held itself as being qualified to act,¹⁵⁹ or implied that it was qualified to act as a solicitor.¹⁶⁰

Pursuant to section 190 of the Act the penalty for such an offence is a fine which is not in excess of \$1,000.00 and, where the offence is a continuing one, a fine that does not exceed \$100.00 per day.

6.2 An Unlawful Association

It may be concluded from the foregoing discussion of section 64 (1) of the Law Practitioners Act 1982, that the practice of law by a company is unlawful. That being the case, it is submitted that a company formed for an unlawful purpose is itself an illegal or an unlawful association.

Section 13 (1) of the Companies Act 1955 provides that:¹⁶¹

Any seven or more persons associated for any lawful purpose may ... form an incorporated company ...

Likewise, section 353(1) of the Companies Act 1955 states that:¹⁶²

... it shall be lawful for any number of persons not exceeding 25 associated for any lawful purpose ... to form a private company ...

It is evident from these two provisions of the Companies Act 1955 that a company must be formed for some legal purpose or object, the Registrar of Companies can refuse to register a company formed to pursue some illegal object.¹⁶³

That the Registrar can refuse registration indicates that the illegality complained of is evident from the outset from the objects of the company as set out in the Memorandum of Association, or perhaps from the name of the company. Is a company that is formed to practice law, after 1 January 1984, the name of which discloses no illegality and the Memorandum of which contains no objects, an illegal association? That is, having achieved registration and a certificate of incorporation issued pursuant to section 29 of the Companies Act 1955, can that registration be upset? It was held in Bowman v. Secular Society Limited¹⁶⁴ that, although a certificate of incorporation is conclusive that the requirements of the Act have been complied with, it is not conclusive of the objects or purpose of the company being legal. Accordingly, where the company's purpose is not lawful, the Crown can institute proceedings by way of certiorari to cancel that registration.

The effect of being an unlawful association is that a company, quite apart from being liable to deregistration at the suit of the Attorney-General, has no capacity to sue either outsiders or its own members,¹⁶⁵ and neither may a trustee or agent sue upon its behalf.¹⁶⁶ The practical implications are of course that an incorporated legal practice would find itself unable to enforce debts owed to it either by clients or by past members, and, being void, would find itself subject to attack by the Commissioner of Inland Revenue in respect of those taxation advantages it sought by purporting to incorporate.

Additionally being in breach of the Law Practitioners Act 1982, it would be subject to the penalties prescribed by section 190.

6.3 Questions of Ethics

In Part 2 of this paper considerable discussion was devoted to the traditional concepts of a profession and the ethical standards that have arisen from them. It is evident that many perceive that breakdown of those traditional values will inevitably occur should law firms be permitted to incorporate; that the accountability of the profession will be lost; that its independence will be submerged and a conflict of interest between employer and client will arise.

It is submitted that such fears are without foundation provided that the New Zealand Law Society establishes firm ground rules from the outset, such as a prohibition upon other than practitioners being members of the company. With a little prior thought, an incorporated law firm will in no way prejudice the rights of its clients.

6.3.1 Accountability

Traditionally a client has always been entitled to expect that his solicitor will be fully accountable, without limitation, for his own professional conduct. Additionally, all the partners of a firm have been liable jointly and severally for the actions of each partner.¹⁶⁷

The fear in this regard is that incorporation will restrict the solicitor's accountability to his client. That the majority of a solicitor's clients are not aware of the level of existing personal liability, and would probably be embarrassed to discover that in enforcing a claim they could bankrupt partners they have never met, would not be altered by incorporation as a unlimited liability company.

As was discussed in Parts 3 and 5 of this paper, the only difference to clients, which incorporation as an unlimited liability company would make would be to render the shareholders liable only to the extent of their capital whilst the company was in business. However upon a winding up that limitation would cease and the liability of all shareholders become unlimited.¹⁶⁸

Perhaps the greatest difference in this regard is for the retired member, whose liability ceases one year after leaving the company.¹⁶⁹ This is in direct contrast to the partner whose liability continues for life in respect of acts or omissions during his membership of the partnership.¹⁷⁰ However, this factor it is submitted is not contrary to the public interest.

Were limited liability incorporation permitted, it is difficult to imagine the New Zealand Law Society allowing company members to escape accountability. Compulsory insurance could be required, or, pursuant to section 201 of the Companies Act 1955, the liability of the directors resolved as being unlimited. Alternatively, as is proposed in Victoria, blanket guarantees could be required from all the members.¹⁷¹

6.3.2 It is arguable whether a limited liability company offers much more than an illusory limitation of liability in many respects. It is standard commercial practice today to require members to personally guarantee borrowings, leases and other financial contracts, and therefore liability for most major debts of the company remains. Whether or not an action against an individual solicitor for negligence in tort is available is debatable. The Court of Appeal in Rowe v. Turner Hopkins & Partners¹⁷² considered it was not required to decide whether the law as expressed in McLaren Maycroft & Co v. Fletcher Development Co. Ltd.,¹⁷³ that a man who exercises a professional skill can be liable only in contract and not in tort was correct, but suggested that the question needed revision in view of recent English decisions. An action in contract may not be available against the individual solicitor, a client's contract for services being with the company. As already noted, the potential to limit liability would certainly be countered by a New Zealand Law Society requirement for a minimum level of professional indemnity cover, unlimited liability of directors, or blanket guarantees from all members. Regardless, it is quite clear that adopting such measures ensures that a solicitor remains fully accountable to his client for his professional conduct despite incorporating.

6.3.2 Independence and conflicts of interest

It is considered that the incorporation of a legal practice would not impair the independence of the profession, nor would it give rise to any conflicts of interest that do not already exist, provided that certain safety measures were implemented. It is for this reason that the New Zealand Law Society must exercise some control as to who may be a member of an incorporated practice and, if outsiders are permitted, in what capacity.

It is not difficult to imagine an incorporated practice where lay people have some shareholding - the impact that this would have on the independence of the profession and the potential conflicts of interest that could arise.

6.3.3 Whether a lay shareholder were a family member, an unrelated third party or perhaps even an institutional investor (such as a bank), would probably matter little. The potential problem still remains. In such a situation, where would the first duty of a solicitor lie? It is suggested that inevitably the solicitor would be subject to the directions of the employing company rather than to those of his client.

This is more than a conflict of interest; it is a complete compromise of the independence of the profession. For this reason the New Zealand Law Society must exercise control over membership of the corporate law practice.

This control could be exercised in one of two ways - either by imposing a blanket ban upon other than practitioners being members of the company or by permitting limited outside membership subject to rigorous control. It is suggested that the New Zealand Law Society would opt for a blanket ban, viewing the integrity and perceived independence of the profession as more important than the opportunity for income splitting via divestment of shareholding. Were family members or dependants of a practitioner permitted to hold shares then those shares would need to be non-voting shares, redeemable by the company immediately upon the death or retirement of the practitioner concerned and further, only practitioners could be permitted to be the directors and secretary of the company.

6.3.3 The code of ethics

Additional impediments to incorporation are currently to be found in the New Zealand Law Society's Code of Ethics, the general tenor of which, in keeping with the Law Practitioners Act 1982, is contrary to the concept of incorporation. The Rules contained in the Code are applicable to the natural person as opposed to the artificial person, and therefore substantial changes would be required before the incorporated practice could sit comfortably with them. Where lay share holding was permitted, Rules currently prohibiting the sharing of costs with other than practitioners would need to be relaxed,¹⁷⁴ as of course would those controlling the

wording of firm names,¹⁷⁵ the information upon the practice stationery¹⁷⁶ and the style of the practice's name-plate.¹⁷⁷

6.4

Conclusion

Before a law firm could lawfully incorporate in New Zealand, section 64 of the Law Practitioners Act 1982 must be amended. Additionally sections 54, 55, 56 and 65 of the Act all of which refer to the natural person as opposed to the corporate personality would also require amendment. Similarly the Code of Ethics of the New Zealand Law Society would not sit comfortably with incorporated practices without considerable redrafting.

Whether changes should be made to the likes of the Administration Act 1969 to permit incorporated legal practices to receive a grant of probate or letters of administration; and whether section 456(1) of the Companies Act 1955 should be amended to permit law to be declared a profession customarily carried on in both corporate and unincorporate form to the intent that partnerships be permitted to remain with up to 50 partners are questions for the profession to answer as a whole.

Whatever changes are desired to be made might best be affected by enactment of a new statute prescribing both ethical safeguards and the machinery necessary for implementation of the corporate system.

Part 7 CONCLUSION

Lawyers in New Zealand are practising their profession in an increasingly deregulated and competitive free market economy in which they are seeing the erosion of their traditional privileges and monopolies; a resultant upsurge in competition whilst facing greatly increased pressure to provide the consumer with value for money. At the same time there has not been a relaxation of the expectation that lawyers maintain the traditional values of the profession - independence, high standards of skill and conduct, accountability and dedication. If anything these values are of greater significance now than ever before.

Against such a background there exists a basic inequity in that the legal profession is still prevented from incorporating; an inequity made all the more unjust when it is evident that the unlimited liability company would permit incorporation whilst maintaining all the traditional values of the profession.

Incorporation may not suit all lawyers, and certainly the advantages available via the corporate form may not be as great as sometimes envisaged. Certainly the principal advantages are taxation orientated. Employer subsidised superannuation would give the corporate solicitor/employee the advantage of superannuation, subsidised by and tax deductible to the company.

Additionally, lump sum tax free retiring allowances would be available pursuant to section 68 of the Income Tax Act 1976.

One major disadvantage presently facing the partnership is the cost of providing working capital from partners' funds taxed at the highest personal marginal rate. When compared to the cost of providing corporate capital via retained earnings taxed at the company rate, the cost of maintaining and strengthening the partnership business as opposed to the corporate business becomes patently obvious. Assuming the present Government completes its proposed taxation reform, this gross anomaly will disappear.

Whilst other advantages, such as the perpetual succession of the corporate identity do flow from incorporation other supposed advantages such as limited or reduced liability are largely illusory.

Partial incorporation to obtain superannuation benefits has been increasingly adopted by the profession over the past two years. Whilst a somewhat clumsy and artificial device the superannuation service company does currently permit firms with six or more partners to obtain limited superannuation benefits. The banding together of groups of small firms and sole practitioners to obtain the prerequisite six shareholders required for superannuation purposes has been suspended whilst the objections of the Government Actuary are overcome.

The unlimited liability company provides an ideal vehicle for incorporating law firms, in that the accountability of the lawyer for this actions will remain, whilst with New Zealand Law Society insistence that all members be practitioners the independence of the profession will be

preserved. The unlimited liability company is preferred to the limited liability company primarily because of the ease of administering the former with regard to the coming and going of company members. The capital of the company can be increased or reduced without the consent of the courts and accordingly shares issued by or surrendered to the company as required.

The principal impediment to the incorporation of law firms is to be found in section 64 of the Law Practitioners Act 1982, which makes it an offence for a person not enrolled as a solicitor to act as or hold himself out as such. Although probably not designed to prohibit the practice of law in corporate form, that is the effect of the provision, which thus requires amendment before firms can proceed with incorporation. For the avoidance of doubt, several other provisions of the Law Practitioners Act 1982 and the Code of Ethics would also require substantial amendment before the practise of the law and corporate form sat comfortably together.

It is concluded that the continued prohibition on the legal profession practising in corporate form is both inequitable and unnecessary, and that with minor amendment can be laid to rest.

FOOTNOTES

Part 1 Introduction

- 1 Machiavelli, "The Prince", Chapter 6.
- 2 (10/11/61) 133 so. 2d. 557.

Part 2 Public Policy and the Concept of the Legal Profession

- 3 Concise Oxford Dictionary (4 ed. Oxford University Press, London).
- 4 Webster's International Dictionary.
- 5 "The Professions, Expensive Monopolies or Guardians of the Public Interest" a lecture delivered as the Fourth Hamptons Lecture on 14.11.83 by Sir Gordon Borrie and reported in The Journal of Business Law (1984) March, 111, 111.
- 6 [1967] 3 All E.R. 993, 998.
- 7 B. Slane "Presidential Retrospective" (1985) N.Z.L.J. 54, 57.
- 8 LawTalk 215, 24 April 1985, 4.
- 9 Parliamentary Press Release, 19 June 1985.
- 10 LawTalk 209, 5 December 1985, 2.
- 11 Idem.
- 12 Monopolies Commission "A Report on the General Effect on the Public Interest of Certain Restrictives Practices so far as they prevail in the supply of Professional Services" (Cmd 4463, 1970).
- 13 "The Report of the Royal Commission on Legal Services" (Cmd 7468, 1979).

- 14 433 U.S. 350 (1977).
- 15 421 U.S. 773 (1975).
- 16 Organisation for Economic Co-operation and
Development "Committee of Experts on Restrictive
Business Practices Report on Competition Policy and
the Professions" (Paris, 1984).
- 17 "The First Report of the Conveyancing Committee:
Non-Solicitor Conveyancers - Competence and Consumer
Protection" (London, H.M.S.O., 1984).
- 18 P. Downey "Change and the Profession" (1985) N.Z.L.J.
37.

Part 3 Incorporation

- 19 LawTalk 165, 9 February 1983, 2.
- 20 Brill & McLeod "The Incorporation of Legal Firms"
(1965) N.Z.L.J. 271.
- 21 Reported in LawTalk 219, 19 June 1985, 5.
- 22 Idem.
- 23 Report of the Royal Commission on Legal Services
(1979; Cmnd. 7648)
- 24 LawTalk 212, 6 March 1985, 3.
- 25 Supra. n. 21.
- 26 Companies Act 1955, s.165(1) (c).
- 27 Income Tax Act 1976, s.10 (1) (b).
- 28 Partnership Act 1908, s.4 (1).
- 29 Income Tax Act 1976, s.10 (1) (b) (i).
- 30 Ibid. s.10 (1) (b) (iii).
- 31 [1975] 5 A.T.R. 565, 570 per Mason J.

- 32 Although the Commissioner of Inland Revenue has a discretion pursuant to section 190 of the Income Tax Act 1976 as to excess remuneration paid to shareholder - employees of proprietary companies, it is not generally invoked unless that remuneration is manifestly excessive. In such a case what is considered excessive is deemed a dividend.
- 33 Statement on Taxation and Benefit Reform 1985.
- 34 Spratt v. C.I.R. [1964] N.Z.L.R. 272; Kelly v. C.I.R. [1970] N.Z.L.R. 161; Freed v. C.I.R. [1970] N.Z.L.R. 272.
- 35 F.C.T. v. Everatt [1980] 10 A.T.R. 608.
- 36 Idem.
- 37 27 N.Z. Current Taxation, No. 7 (May 1983) 237; C.A. Staples, A Guide to New Zealand Income Tax Practice (45 ed. 1984-85) paras 501-502.
- 38 Supra. n. 36.
- 39 Newtown v. F.C.T. [1958] 98 C.L.R. 2; Slutzkin v. F.C.T. 77 A.T.C. 4076.
- 40 Illustration upon the basis of income tax rates applying in 1985, rounded to nearest thousand dollars for ease of comparison.
- 41 Income Tax Act 1976, s. 150 (3), although pursuant to s.160 (5) (a) the Commissioner has a discretion to permit a higher deduction if he considers it equitable.
- 42 Income Tax Act 1976, s.150 (1) (d).
- 43 Ibid. s.150 (1) (e).
- 44 Ibid.s.59 (5) (b): maximum deduction permitted is \$1200.00 per annum.
- 45 Income Tax Act 1976, s.106 (1) (m).

- 46 P.R.H. & A. Webb Principles of the Law of Partnership (3 ed. Butterworths, Wellington, 1983) p.25.
- 47 Income Tax Act 1976, s.150 (1) (d).
- 48 Partnership Act 1908, s.36 (1).
- 49 Re Estate of J.H.R. Bloomfield, Baldwin & Robinson v. C.I.R. (1978) 2 T.R.N.Z 587.
- 50 Companies Act 1955, s.27 (3).
- 51 Pyne Gould Guinness (Ltd.) Trust Act 1934.
- 52 A practice recently welcomed by Trade and Industry Minister, Mr Caygill. Main Report, Christchurch 13 September 1985.
- 53 Partnership (Law Practitioners) Order 1982 (S.R. 1982/120).
- 54 Re Smith Knight & Co., Weston's Case ([1868]) 4 Ch. App. 20.
- 55 [1875] L.R. 7 H.L. 653, 671.
- 56 e.g. Wellington Bowling Club v. Siewwright [1925] G.L.R. 227, in which an Article purporting to prohibit altogether a transfer of shares was held illegal and void.
- 57 Re Smith & Fawcett Ltd. [1942] Ch,304.
- 58 [1960] Ch. 1.
- 59 Borlands Trustee v. Steel Brothers & Co. Ltd. [1901] 1 Ch. 279.
- 60 Philips v. Manufacturers Securities Co. ([1917]) 116 L.T. 290.
- 61 Supra. n. 58.
- 62 Supra. n. 56.
- 63 The Accountants Journal Wellington, New Zealand, July 1985, p.6.

- 64 Ibid. June 1985, p.11.
- 65 The claims against the accounting profession all stem
66 from auditing, where a large number of people rely
67 upon the information provided. Perhaps the only
68 remotely analagous situation in law is a takeover
69 situation.
- 66 Bowring Burgess Marsh & McLennan.
- 67 The Report of the Royal Commission on Legal Services
(1979; Cmnd. 7648).
- 68 Ibid. para 30.22 402.
- 69 eg. Stockbrokers in the UK; proposal re Victorian
Solicitors.

Part 4 Partial Incorporation - the Superannuation service
company

- 70 Equivalent of section 150 Income Tax Act 1976, of New
Zealand.
- 71 Income Tax Act 1976, s. 150 (3) (b).
- 72 Ibid. s. 149 (note administration costs may be included
73 as part of the "global" employer contributions, and
74 claimed under s.150 (3) (b), but in so doing the amount
75 credited to each member's individual accumulation
76 accounts reduced correspondingly.
- 73 Although the cost of life cover may be debited against
74 individual members' accumulation accounts in the fund, it
75 is preferable in this situation for the service company
76 to meet the costs of life cover separately, and claim
pursuant to s.149 of the Income Tax Act 1976.
- 74 Income Tax Act 1976, s.149.
- 75 Ibid. s.150 (4).
- 76 Based on 1984 Income Tax Tables.

- 77 Not taking into account Superannuation Fund and Service Company expenses or Group life premiums.
- 78 Income Tax Act 1976, s.150 (3) - generally ten per cent of the aggregate of salaries paid to scheme members.
- 79 The Australian Administration Company is what we refer to in New Zealand as the Service Company. The term "Service Company" as employed in Australia and the United Kingdom refers to a different beast which is more in the nature of an income splitting device, receiving fees from the practice for such functions as owning the lease of the office, owning equipment and employing staff; the shares often being held by other than the partners.
- 80 New clause 7.3 inserted in the Code of Ethics, published in full in the April 1982 edition of the The Accountants Journal Page 85, published by New Zealand Society of Accountants, Wellington.
- 81 Letter to the author dated 5th October 1983 from the then Secretary-General of the New Zealand Law Society, Mr W. M. Rodgers.
- 82 LawTalk 204, 1.
- 83 Published in "Memorandum re Superannuation Service Companies" dated 24th February 1982 by the New Zealand Society of Accountants.
- 84 Idem.
- 85 Income Tax Act 1976, s.150.
- 86 Ibid. s.104.
- 87 Ibid. s.6 (2).
- 88 Ibid. s.150.
- 89 Less than six partners.
- 90 Income Tax Act 1976, s.150 (1).
- 91 LawTalk 209, 5 December 1984, 7.

- 92 Snook v. London & West Riding Investments Ltd. [1967] 2
Q.B. 786; Paintin & Nottingham Ltd. v. Miller Gale &
Winter [1971] N.Z.L.R. 164.
- 93 Gibson v. Tyree [1901] 20 N.Z.L.R. 278.
- 94 Surpa. n. 92.
- 95 LawTalk 213, 20 March 1985, 3; Council Brief 114,
February 1985, 1.
- 96 LawTalk 213, 20 March 1985, 3.
- 97 e.g. New Zealand Educational Institute v. Director -
General of Education [1981] 1 N.Z.L.R. 538.
- 98 Supra. n. 92.

Part 5 The Unlimited Company

- 99 Companies Act 1955, s.21(1).
- 100 Ibid. s.14(4) (a).
- 101 A "member" of a company is defined by s. 39 of the Act to
include inter alia "Every person who agrees to become a
member of a company, and whose name is entered in its
register of members, shall be a member of the company".
- 102 Companies Act 1955, s.21(2).
- 103 Ibid. s.21(3).
- 104 Ibid. s.14(1).
- 105 Ibid. s.25(d).
- 106 Idem.
- 107 s.21(3) to be notified to the Registrar within fifteen
days.
- 108 Re Borough Commercial v. Building Society [1893] 2Ch.242
- 109 Partnership Act 1908, s. 12.
- 110 Re Mayfair Property Company [1898] 2Ch. 28.

- 111 Pennington "Company Law" (4 ed. Butterworths, London, 1979), 669.
- 112 Companies Act 1955, s.253(2) (a).
- 113 Re West of England Bank, ex parte Branwhite [1879] 48 L.J. Ch 463.
- 114 Supra. n. 110, per ~~Lord~~ Lindley M.R., 35.
- 115 Companies Act 1955, s.211(1) (c^d).
- 116 Ibid. s.211(1) (a).
- 117 Ibid. s.211(1) (b^c).
- 118 Ibid. s.14(4) (a).
- 119 But note the limited power to alter the Memorandum contained in the Companies Act 1955, s.18(2).
- 120 Companies Act 1955, s.362.
- 121 Ibid. s.75.
- 122 Supra. n. 108.
- 123 Ibid. s.147(4) (a) which via the operation of s.362(7) also applies to private unlimited companies.
- 124 (1887) 12 App. Cas 409.
- 125 Ibid. 433.
- 126 Supra. n. 124.
- 127 Idem.
- 128 Re Borough and Commercial Building Society (1893) 2 Ch 242.
- 129 Supra. n. 111.
- 130 Idem.
- 131 Halsbury's Laws of England Vol 7, para 72¹⁷⁵ (4 ed. Butterworths, London, 1974)
- 132 Companies Act 1955, s.362.
- 133 Ibid. s.145.
- 134 Companies Act 1955, s.354(2).
- 135 Ibid. s.353(1).

- 136 Ibid. s.354(3B).
- 137 Idem.
- 138 Ibid. s.354(2A).
- 139 Ibid. s. 354 (3)
- 140 Securities Act 1978, s.2(1).
- 141 Ibid. s.50.
- 142 Companies Act 1955, ninth schedule.
- 143 Ibid. s.353(2).
- 144 Wellington Bowling Club v. Sievwright [1925] G.L.R. 227.
- 145 Attorney General v. Jameson [1904] 2 Ir R 644.
- 146 Re Smith and Fawcett Ltd [1942] Ch 304
- 147 Charles Forte Investments Ltd v. Amanda [1964] Ch 240.
- 148 Law Practitioners Act 1982, s.64(1); emphasis added.
- 149 Law Practitioners Bill, Explanatory Notes, page 10,
(Government Printer, Wellington, 1981).
- 150 Ss.13(1) and ³253(1).
- 151 Re Sheffield & South Yorkshire Permanent Building Society
(1889) 22 Q.B.D. 470 per Cave J. 476.
- 152 Salomon v. Salomon & Co. Ltd. [1987] AC 22, H.L. per Lord
Macnaghten, 51.
- 153 Ibid. per Lord Halsbury, p. 30.
- 154 Law Society v. United Service Bureau Limited [1934] 1K.B.
343.
- 155 Business Consultants Ltd. v. Butler Unreported High Court
Auckland. M. 1632/83, 25 June 1984.
- 156 H.G. Henn & A.J. Alexander Corporations (3 ed.) p. 145.
- 157 Supra. n. 155.
- 158 Law Practitioners Act 1982, s.64(1) (a).
- 159 Ibid. s.64(1) (b).
- 160 Ibid. s.64(1) (c).
- 161 Emphasis added.

- 162 Emphasis added.
- 163 R. v. Registrar of Companies, ex parte More [1931] 2K.B.
197 C.A.
- 164 Bowman v. Secular Society Ltd. [1917] AC 406 H.L.
- 165 Jennings v. Hammond [1892] 9 Q.B.D. 225.
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- 167 Partnership Act 1908, s. 15.
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[1973] 2 N.Z.L.R. 100.
- 174 Code of Ethics, Rule 1.3.3.
- 175 Ibid, Rule 1.4.1.1.
- 176 Ibid, Rules 1.2.8; 1.2.9. & 1.2.10.
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