Setting Up A Business From A Legal Point of View.

The first thing to do is to decide exactly what form of business you wish to set up. There are many considerations when choosing an organizational form. They range from how the business will be owned and managed to tax, legal, and financial implications. As such, you want to choose the form that suits your purposes best. Businesses concerned with liability issues for example, may want to incorporate as this form legally separates the business owner from the business' liability. If the over-riding concern is expediting the formation of the business at a low cost, sole proprietorship may be the best avenue. There can also be special considerations for an agriculture or farming type business. We recommend that your first talk to your accountant about what type of business to set up from a tax point of view as proper tax planning will save time, money and aggravation from a legal and practical perspective.

If you choose to incorporate, our role is then take the accountant's letter of instruction and set up an incorporated entity with the share structure that will work best for you from a tax point of view. However, there are three basic forms of business organization to pick from. They include:

Sole Proprietorship,

Partnership, and

Incorporation.

Other forms such as Cooperatives and Joint Ventures do exist, and while they tend to be less common we have experience in creating these relationships. We have also set up many Professional Corporations which are specialized corporations set up for specific professions such as accountants, doctors, lawyers, etc.

Sole Proprietor

Essentially, as a proprietor, you are the business. You may operate under your own name, but use caution. If the business fails your name is associated with that failure. Also, be aware that you can only use your legal birth certificate name. No additions or changes can be made to this name for the purpose of doing business. Alternatively, you may register a trade name. With a proprietorship, your business income is your personal income. It will be reported on your personal income tax return and will be taxed at personal income tax rates.

The ***advantages*** of starting a proprietorship are many. Start-up costs are low. Proprietorship is the least expensive way of setting up a business. It allows for simplified filing procedures and the owner is in direct control of decision making. All profits from the business go to the owner.

There are ***disadvantages*** to sole proprietorship as well. There is, for instance, a lack of continuity of the business in the absence of the owner. Perhaps the biggest disadvantage however, is the unlimited liability you will face as a proprietor. Should something unfortunate happen and a customer decides to sue your business for example, you can be held personally responsible (i.e. your personal assets are at risk). Or alternatively, if your business goes into debt, you are personally obligated to pay it back. Again, your personal assets may be seized to pay back creditors.

Generally speaking, proprietorship may be a good choice for you if your business profit does not adversely affect your personal income tax and if your business carries little risk of debt or lawsuit. Check with your insurance agent for the various types of coverage you can get for the business.

We always advise against operating as a sole proprietorship or as an unincorporated entity due to the unlimited liability you could face. However, from a tax perspective, it may be better to do so especially if you are in the agricultural business.

Partnerships

A partnership is formed when two or more individuals (including corporations) come together to practice business under one name. The Partnership Act in Alberta defines partnership as "...the relationship that subsists between persons carrying on a business in common with a view to a profit." This definition applies to individuals who have agreed to operate as partners regardless of whether or not they have put the agreement in writing. Although a partnership is a separate entity from it's owners, each partner is equally responsible and totally liable for all business debts and obligations. As such, it may be in your best interest to have a legal agreement drawn up outlining the terms and conditions of the partnership. This will make life a lot easier if there happens to be a disagreement between the partners down the road. Partnership agreements can be designed to suit the type of business you and your partner/s envision. For example, you may choose to enter into a :

general partnership, where all partners contribute management and money or assets, or into a ;

limited partnership, where certain partners may contribute money but that is the extent of their involvement. They are not involved with managing the business.

Like the proprietor, partners have unlimited liability. They are held personally responsible for all that happens with their business. This may be a concern if, for example, one partner undertakes activities that the others are not aware of and negative results occur. The consequences, unfortunately, will be on the shoulders of each partner, not just the partner who independently undertook the action.

Income that you draw from the partnership is treated as personal income. It is filed on your personal income tax return and is taxed at personal rates.

Incorporation

When you incorporate, you establish a separate legal entity which divides your personal affairs from your business. In effect, a corporation is a distinct legal "person", responsible for its own matters. A corporation is owned by one or more persons, called shareholders. The shareholders' liability is limited to what they put into the corporation and anything they guarantee on behalf of it. This "limited liability" is one of the main reasons that small businesses incorporate. A basic responsibility of the shareholders is to hold a meeting once a year to elect a "Board of Directors" who will run the corporation's day to day affairs.

The second major reason for incorporating is for tax purposes. Unlike proprietors and partnerships, a corporation is taxed separately from the owners, on its profits, and must file a tax return. Many Alberta corporations with a taxable income of under $200,000 pay a tax rate of only 19%. Compare that to a proprietor with $200,000 of profit added to his or her personal income and you can see why this would be a big reason for some businesses to incorporate! Be aware however that not all businesses or all sources of income can qualify for this lower rate. Check with Canada Customs and Revenue Agency or your accountant for information on the Small Business Deduction. If you are the shareholder in 2 or more corporations that are not arms length, you also need to be aware that the small business tax deduction may be pro-rated amongst the corporation-again we urge you to seek tax advice in advance in order to plan for any unpleasant surprises.

If you are starting a business, and are employed, you may not want to add more income to your personal total. If your business is incorporated, you can control the amount of personal income you receive from your business. If you operate as a proprietor, all profits from the business become personal income and are taxed accordingly.

There are other reasons to consider incorporation. It is often easier to raise capital by selling shares in the company (beware though that there is a difference though between privately held corporation and publically traded companies and there are special rules to each for raising share capital). These shares then become part of the buyer's estate. Additionally the life of the business is not tied to the life of its owner or owners.

One of the major disadvantages of incorporating is the amount of administration required to run a corporation. The shareholders (owners) are required to hold annual meetings and record the minutes of those meetings in the corporation's "minute book". Similarly, the Directors are required to meet annually and again, minutes must be recorded in a minute book. In addition, every corporation must file a tax return. The corporate tax forms are quite complicated. Most small businesses use professionals like accountants or lawyers to perform these duties.

For both Federal and Provincial corporations, a NUANS (Newly Upgraded Automated Name Search) report will be required if you intend to use a corporate name. This is a search for a company name at corporate registries, which our office has online access to and which is provided for in our incorporation fee. The name you pick for your company must be searched in order to verify that no one else has registered that name. You must indicate to the Agent or Searcher whether or not you intend to incorporate federally or provincially as this will affect the type of search that the Searcher of Records perform (i.e.

Federally incorporated companies require a national search and provincial companies require a province-wide search).

When you incorporate, a mandatory legal element is added to your name. (i.e. Inc. Ltd. Corp.) For businesses not concerned with obtaining a corporate name, a numbered company is always an option. You will not be required to have a NUANS report done for a numbered company.

Federally incorporated companies have heightened name protection. A federal corporation will be granted their name before a provincially incorporated company should they both apply for the same or similar names. Federally incorporated companies must still register in each province in which they intend to "carry on business" as do provincially incorporated companies. The difference is that as a federally incorporated company, you have the right to carry on business in any province. Provincial corporations do not carry that legislated right. Each province has the discretion of granting you the right to register in their province if you are provincially incorporated. Please note that registration extra-provincially is rarely a problem. We have experience in assisting with companies getting registered extra-provincially but caution that may be best to have companies registered in each jurisdiction in order to provide more protection from liability.

While it is possible to get a certificate of incorporation from Corporate Registries, we advise that this does not give the company the by-laws and articles that it needs to necessarily conducted its business from day to day. Many of our clients that have used this approach ultimately come to our office to have their company reorganized which takes more time and costs more money than if we simply incorporated the company from scratch.

In any event, we would be pleased to meet with you to discuss your corporate need.