Business Organizations

SHK

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TRUSTED LEGAL ADVICE

Agenda

- Sole Proprietorship
  - What, how, advantages, disadvantages
- Partnership
  - What, how, types, advantages, disadvantages
- Corporation
  - What, how, characteristics, advantages, disadvantages
- Risk Mitigation Strategies
- Questions

Remember

- It’s almost always about the money!!!
  - Income maximization and cost containment
  - Minimize liability and risk exposure

Sole Proprietorship

What Is It??

- Simply an individual carrying on a business on their own

How to Create??

- Obtain a business licence
- Should register a business name, but not required
- Be aware of registrations specific to the business

Sole Proprietorship

Advantages	Disadvantages

• Simple, fast & inexpensive start-up cost
• Fewer ongoing reporting obligations
• Less government regulation
• Little overhead
• Risk can be reduced with insurance
	• Personally responsible for all debts and obligations of the business
	• Almost all assets are at risk of loss
	  • Bank accounts, home, cars, etc.
	• Unlimited liability to the world at large
	  • Vicarious liability for those acting in your name
	• Income is reported and taxes paid at time it is earned
	• Very little brand protection
	• No continuity in absence of owner
	  • Restricts money-raising options

Partnership

What Is It??

- The simplest available form of business where people pool resources with a view to making a profit in an ongoing business
- Not a separate legal entity from the partners
  - Except in the case of a Limited Partnership

How to Create??

- By the actions of the parties – even if unintentional
  - *Partnership Act*
- By agreement (i.e., a Partnership Agreement)

Partnership

<u>Types</u>

- General Partnership
  - Can be created by actions of the parties
    - If parties operate an ongoing business together and share management, expenses and profits, then likely a partnership
  - Can be created by agreement of the parties – oral or written
    - Formal partnership agreement
    - Agreement that, by its terms, creates a partnership
      - Question of law, not the terms of agreement

General Partnership

Advantages	Disadvantages

• No registration required to create
• Fewer ongoing reporting obligations than companies
• Income and expenses can be shared by the partners in different proportions
• Division of labour and sharing of risk
• Combine resources and expertise
	• Each partner liable for the actions of ALL partners
	  • All assets are at risk
	  • Vicarious liability
	• Each partner is an <u>agent</u> for ALL partners
	  • Can bind each and every partner in contract
	• Partnership Agreement will not limit liability to the world at large
	  • Deep pockets . . .
	• Partners are fiduciaries
	  • Must act in the interests of the partnership
	• Little opportunity to defer income tax liability

Partnership

Types

- Limited Partnership (LP)
  - Has limited partners - who contribute only capital
    - money or in-kind transfer
    - not involved in managing the business
    - cannot be liable for more than the amount of capital contributed
  - Requires a general partner, who manages the business
    - general partner is fully liable for the debts and obligations of the business, but may be entitled to a greater share of the profits

Limited Partnership

Advantages	Disadvantages

• Fewer ongoing reporting obligations than companies
  • But is the GP a company?
 	
• Income and expenses can be shared by the partners in different proportions
 	
• Liability and risk is limited to money invested
 	
• Broader management base, continuity of business
  • Increases money-raising opportunities
	• Partners may still be fiduciaries
	  • Must act in the interests of the partnership
	• Little opportunity to defer income tax liability
	  • Some ability to keep income parked in the GP
	• Easy to lose 'limited partner' status
	  • Participate in the business, provide services to business
	  • Liability converts to unlimited
	• Partnership Agreement may limit marketability of LP Units
	• Difficulty in finding like-minded partners

Partnership

<u>Types</u>

- Limited Liability Partnership (LLP)
  - Combines characteristics of General and Limited Partnership
    - Not a separate legal entity from the partners
    - All partners are active in management of the business
    - Any partner can bind the partnership
    - BUT each partner is only liable to the world at large for the money they have put into the partnership
      - Vicarious liability, but not unlimited
- Most often used by professionals
- Legislation usually requires insurance

Corporation

What Is It??

- A legal ‘person’ that is separate and distinct from its members (shareholders).
- Incorporated in BC according to the provincial *Business Corporations Act* or federal *Canada Business Corporations Act*
- Has all of the powers of a person, an independent existence – separate and distinct from its shareholders – and an unlimited life expectancy.
  - Can acquire assets, go into debt, enter into contracts, sue or be sued.
- Ownership interests are usually easily changed.

How to Create??

- Application for incorporation
- Articles of incorporation
- At least one director and one shareholder
- Must use either Inc., Corp. or Ltd. in its name

Corporation

Distinguishing characteristics

- **Limited Liability**: normally no member can be held personally liable for the debts, obligations or acts of the corporation beyond the amount of share capital the shareholder has put in
  - Be careful about piercing the corporate veil . . .
- **Perpetual Succession**: because the corporation is a separate legal entity, its existence does not depend on the continued membership of any of its shareholders.

Considerations for Professionals!

- If a professional corporation (i.e., an engineering firm), then must:
  - Comply with any additional incorporation and ongoing obligations of its regulatory body
  - Employ persons licenced to practice in that profession

Corporation

Separate Legal Entity

- The company is a legal 'person' in its own right
  - It acts through its shareholders, who vote for a slate of directors to run the business
- Can sue, be sued, enter into contract, employ, etc., in its own name
- Separate legal person doesn't always mean absence of liability
  - If a small company, then the shareholders may have to guarantee debts or provide security
- For professionals, liability may arise out of their governing legislation
- If a shareholder or director uses the company to commit a fraud, then courts may *pierce the corporate veil*

Corporation

Shareholders and Directors

- The company is a legal ‘person’ in its own right
  - It acts through its shareholders, who vote for a slate of directors to run the business

- Legislation and case law dictate shareholders’ and directors’ obligations / exposure
  - Shareholders have very little exposure beyond the money invested
  - Directors are fiduciaries to the company
    - Must act in interest of company to detriment of own interests and must disclose conflicts of interest
  - For directors to escape liability, must perform reasonable due diligence
    - Risk of ‘willful blindness’
- If a shareholder or director uses the company to commit a fraud, then courts may *pierce the corporate veil*

Corporation

Advantages	Disadvantages

• Possible tax advantages
  • Income treatment can be deferred or sprinkled
• Limited liability
• Ownership is transferable
• Continuous existence
• Separate legal entity
• Easier to raise capital
	• Closely regulated and lots of on-going reporting
	  • Annual filings, change of directors, etc.
	• Most expensive form of business to organize
	  • higher start-up costs related to professional fees for legal and accounting services
	• Extensive recordkeeping necessary
	  • Legal and accounting
	• Shareholders and/or directors may be held legally responsible in certain circumstances
	• Personal guarantees undermine limited liability advantage

Risk Mitigation Strategies

- Consider establishing your business as a corporation or limited partnership rather than as a proprietorship or partnership.
- Invest by way of registered secured debt and minimize your investment in share capital.
- Hold assets such as real estate and equipment in a company separate from the parent company
- **Obtain appropriate insurance coverage.**

??Questions??


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