Business Start Up

Business Ownership in Canada

NLOWE

NEWFOUNDLAND & LABRADOR ORGANIZATION OF WOMEN ENTREPRENEURS

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Of all the choices, you make when starting a business, one of the most important is the type of legal structure you select for your company. Not only will this decision have an impact on how much you pay in taxes, it will affect the amount of paperwork your business is required to do, the personal liability you face and your ability to raise money. The answer to the question of "What structure makes the most sense? depends, on the individual circumstances of each business owner. Each situation is different you cannot just assume that one form is better than another. It's not a decision to be entered into lightly, either, or one that should be made without sound counsel from business experts. There are four common forms of business ownership in Canada.

- Sole Proprietorship
- Partnership
- Corporation
- Cooperative – info not included in this document

Each of these forms of business ownership has advantages and disadvantages that you will want to weigh before choosing a particular form of business for your new venture.

Sole Proprietorships

A **sole proprietorship** is the *simplest and most common form of business structure*, and it is the oldest form of legal ownership in Canada. It is owned by one person who retains all of the legal rights and bears all of the responsibilities associated with the business. The owner enjoys all of the profits flowing from the business and is responsible for all of its debts. The business is **not** considered as a separate entity from the owner. In other words, the firm is part of the owner.

The income of the business is reported as personal income on the owner's personal income tax return, and is taxed at the same rate as the owner's other personal income, if any.

Advantages of a sole proprietorship

- A sole proprietorship is the simplest and least expensive type of organization to create or dissolve.
- Sole proprietorships are not governed by any specific legislation. Each province, however, has some specific regulations. (*see note below)
- The owner retains absolute control over business decisions and is the sole owner of any profits from the business.
- The profits of the business are not taxed as a separate entity, only as part of the owner's personal income.
- Unlike an employee, a sole proprietor can deduct business expenses from personal income.

*How to Register a Business in Newfoundland & Labrador

The process of registering a business varies from province to province. Here's an overview of how you would register a business in Newfoundland & Labrador, there is no legislation at this time in Newfoundland & Labrador governing the registration of business names, sole proprietorships or partnerships. That means you can open your sole proprietorship or partnership business in Newfoundland & Labrador without registering a name and, most importantly, without shelling out a dime. You can use the Companies and Deeds On-line (CADO) https://cado.eservices.gov.nl.ca/Main.aspx to perform basic searches of the Registry of Companies no cost. Sole proprietorships and partnerships are not permitted to use the words 'incorporated', 'corporation'; 'limited' or the abbreviation of any of these words in their names.

Disadvantages of a sole proprietorship

- The owner faces unlimited liability. Unlike some other business structures, a sole proprietorship is not a separate entity from the owner. Unlimited liability occurs because there is no legal distinction between the owner and the business.
- With regard to liability and taxation, the owner and the business are one in the same.
- Therefore, the owner can be held personally liable for all business debts, or for negligent acts of employees in the course of business.
- Creditors can seize the personal assets of the owner for non-payment of business debts. Unlimited liability implies that the owner is liable for claims against the business, even those that go beyond the value of his or her ownership in the firm.
- The ability to obtain financing may be impaired because the amount of money the owner is able to invest in the business is limited to what available resources he or she has and what he or she is able to borrow.
- In contrast to some other business structures, in which funds can be raised through the sale of equity in the business, the only option available to sole proprietorships is debt financing.
- The ability to obtain this debt financing will depend greatly on the value of the owner's personal assets that can be used for collateral.
    - The owner is solely responsible for all aspects of the business, from day-to-day operation to securing financing. If the business grows, the managerial responsibilities may become too large for one person to handle.
    - Upon death of the owner, the business is legally terminated.
    - The assets may be transferred to a new owner who establishes a new sole proprietorship, but the new owner acquires the business free and clear of all debts, obligations, and other liabilities of the original owner. As a consequence, the resulting taxes payable by the owner's estate may be so substantial that some assets must be sold to meet these obligations.

Corporations

A corporation is distinct from a sole proprietorship and partnership in one fundamental way: it is a *separate legal entity.* It has a legal existence independent from the owners of the business. It can buy, own, and sell property, sue and be sued, and must file its own income tax return.

There are three main groups of people involved in a corporation:

1.Shareholders - They are the owners of the corporation. Common shareholders are entitled to vote at shareholders' meetings on company-related issues such as electing the board of directors and choosing an auditor. Most shareholders are not involved in managing the affairs of the corporation. Shareholders' liability for debts of the corporation is limited to the price they paid for the shares they own. Shareholders receive a portion of profits based on the type and number of shares they own in the corporation. They are entitled to share the assets if the corporation dissolves, after all debt obligations have been satisfied.

2. Board of Directors - The board of directors is elected by the shareholders to guide the affairs of the corporation. Directors owe a fiduciary duty to the corporation, and must disclose any personal interest in any business in which the corporation participates.

3. Officers - Officers are hired by the board of directors. They are responsible for the day-to-day management of the corporation. Unlike shareholders, officers can legally bind the corporation to contracts they sign on its behalf.

In contrast to sole proprietorships or partnerships, a corporation is subject to double taxation. Because it is a separate legal entity, any profits of a corporation are taxed according to corporate income tax rates. Then, if after-tax profits are distributed to shareholders in the form of dividends, the shareholders will be taxed on these dividends. Thus, income from a corporation can be taxed twice: once at the corporate level, and then again when the income is distributed to shareholders in the form of dividends. Shareholder income from dividends does, however, get some form of tax relief in the form of dividend tax credits.

Advantages of a corporation

- A corporation provides limited liability for the owners (shareholders); shareholders are only liable to the extent of their investment in the shares of the corporation.
- As a separate legal entity, the corporation is responsible for its own debts and obligations.

- A corporate structure provides flexibility in the organization of the business, and in the relationship between the owners.
- A corporation has a perpetual existence, so it does not end upon the death of one of the shareholders. This perpetual existence allows for simpler estate planning, without the necessity of re-negotiation of partnership agreements each time a change is made.
- Control and ownership of a corporation are easily transferable by selling shares.
- Corporations may facilitate access to capital because additional shares in the corporation can be sold to raise funds.
- A corporation may be the preferable structure when there is a large number of owners, as it provides for a formal decision-making hierarchy.
- A shareholder can contract with or sue the corporation, whereas a partner can do neither with respect to the partnership and must contract with or sue the partners individually.
- A corporation can provide flexibility of financing.
- The corporation can create different classes of shares, with varying rights and characteristics.
- This flexibility provides more options to investors, as they can obtain a type of investment that most properly fits with their own investment objectives.
- Some government assistance is only available to corporations.
- Corporations may offer possible tax advantages compared to other forms of organization. For example, small businesses that have incorporated may be eligible for the small business deduction.

Disadvantages of a corporation

- The costs of creating and maintaining the corporation can be very high. For instance, the required legal and accounting work may be significant.
- Laws governing corporations are more complex. If a corporation's shares are publicly traded, then the corporation must also follow stringent financial reporting and securities commission requirements.
- Shareholders cannot use corporate losses to offset their personal income.

There are two types of incorporation in Canada; provincial and federal incorporation.

The main difference between the two is that federal incorporation gives your business increased business name protection and wider rights to carry on business. Federal incorporation of your business means that you will be able to do business all across Canada under the same business name, even if some other company is already using a similar name in some province or territory.

This is not the case with provincial incorporation. When you incorporate your business in a particular province or territory, you are only entitled to operate your business in that jurisdiction and have no name protection outside that province or territory. Federal incorporation can be an excellent choice if your business needs the nation-wide business name protection that federal incorporation provides, or if your business is or will be operating internationally. If your business is and plans to be operating primarily within one province, provincial incorporation may be enough for you.

If you wish to incorporate or register a limited liability corporation in *Newfoundland*, there are a number of legal and administrative issues to consider. The cost to incorporate in NL company is $300. Three forms are required: see attached. All forms and information are available online http://www.servicenl.gov.nl.ca/registries/companies/corp_why.html . Because the process of registering a limited liability or corporation is relatively complex, consulting with a lawyer before registering is always recommended.

Partnerships

A partnership is established when two or more people agree to pool their financial, managerial, and technical resources in order to operate a business for profit. Partnerships are most commonly found in professions such as law and accounting. The definition of a partnership, as enumerated in the provincial Partnership Act, is the relation which subsists between persons: carrying on a business in common, with a view to profit from the business. Each partner owes every other partner a duty to act in the best interests of the partnership. Like a sole proprietorship, a partnership is not taxed as a business that is separate from its owners. The income from the partnership is included as part of the partners' personal incomes and taxed accordingly.

Creation of a Partnership - Partnerships may be created either by agreement between the parties, or by the conduct of the parties. However, where a partnership is the desired form of business structure, it is recommended that the partners draw up a written Partnership Agreement. This can help greatly in the settlement of any disputes that may arise in connection with the business of the partnership.

Advantages of a partnership

- •Because two or more people will be in business together, they can combine their finances in order to invest more than either could have done individually.
- A partnership will most likely be able to borrow more than a sole proprietorship because creditors will have the collateral of two or more people instead of only one to secure their lending.
- Partners can pool their talents so that each person can focus on his or her area of expertise in the business.

Disadvantages of a partnership

- Like a sole proprietorship, partners in a partnership are also exposed to unlimited liability incurred by the business. However, unlike a sole proprietorship, each partner can legally bind every other partner. Each partner is jointly and severally liable for all partnership debts, so a partner can be held personally liable for any debts, obligations or wrongful acts of another partner.
- The partnership ends every time a partner leaves, unless provided for in a partnership agreement. In addition, a partner cannot simply withdraw his or her investment from the business. He or she must find someone (or another current partner) who is willing to buy into the partnership in order to replace the exiting partner, and this candidate must be acceptable to the remaining partners.
- Management decisions may be more complex and more difficult to make, particularly when disagreements among partners occur.
- A properly drawn partnership agreement may provide for a mechanism to resolve any decision-making problems.
- Start-up costs can be as high as, or even higher than, the cost of incorporating, once a properly drawn partnership agreement is taken into account.

Limited Partnerships

Limited Partnerships are a special form of partnership, often used where investors want the tax treatment that comes from a partnership relationship, without incurring personal liability for all of the partnership debts. When a limited partnership is formed, one of the partners (usually a corporation with no assets, formed and controlled by the promoter of the investment for this sole purpose) is designated as the "general partner" and all other investors are usually designated as "limited partners". The partnership agreement then makes the general partner responsible for managing the business of the partnership. The limited partners are simply "silent" investors with no say in the business activities of the partnership.

Any income earned by the limited partnership are directed to and taxed in the hands of the partners, and any losses incurred by the limited partnership are allotted amongst the partners and may become a deduction from the taxable income of such partners. A limited partner is restricted in their ability to deduct losses and in aggregate cannot deduct losses which exceed the amount they have invested. This restriction can be less than the amount invested if the partner bought their interest from a former partner and not the partnership. (The ability of a limited partner to deduct losses is restricted and professional tax advice should be received with respect to such restrictions). In the event the limited partnership is unable to meet its obligations, only the general partner will be liable for the debts of the partnership. The liability of a limited partner would be limited to the amount of capital the limited partner invested in the partnership. However, if the limited partner participates in the management of the partnership, that partner would lose his or her "limited liability" and may become liable for the debts of the partnership, the same as the general partner. Limited partnerships are used, for the most part, as a method for structuring tax driven investment ventures. If the investment is tax driven, the limited partnership may have to register with Revenue Canada as a tax shelter.

Which type of business structure to use?

Deciding which type of business structure to use can be difficult. Some questions to ask when choosing among various business structures include:

- How easy and costly is the form of business structure to organize?
- How much capital will the business need?
- How much capital will come from owners and how much debt financing will be needed?
- What are the tax implications of each business structure?
- How much personal involvement should the owners have in controlling and managing the business?
- How much risk and liability for the business should the owners assume?

Business Number (BN) registration

http://www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/menu-eng.html

The BN is a numbering system that simplifies and streamlines the way businesses deal with the federal government. It is based on the idea of one business, one number. Before you register, see Should you register for a GST/HST account? The questionnaire at http://www.cra-arc.gc.ca/tx/bsnss/tpcs/gst-tps/rgstrng/rgstr/q1-eng.html will help you determine if you need to register for a GST/HST program account. It will help you find out if you have to register (Mandatory registration) or if you can register (Voluntary registration). Also use our GST/HST registration checklist to make sure you have the information you need to register for a GST/HST account.

Not all businesses require a BN and CRA program accounts. You only need a BN if you require any one of the following business accounts:

- GST/HST
- Payroll
- Corporate income tax
- Import/Export
- Others

If you decide to register for any one of them, you will receive a BN.

You have to register for GST/HST in the following cases:

- You (resident or non-resident) provide taxable, including *zero-rated* goods or services in Canada in the course of carrying on business in Canada on a regular or continuing basis and your revenues **exceed $30,000** ($50,000 for public service bodies) in a **single** calendar quarter **or** in **four consecutive** calendar quarters

- You are a non-resident and make taxable sales of admissions in Canada for a place of amusement, a seminar, an activity, or an event held in Canada, even if your sales do not exceed $30,000
- you host a convention in Canada, and more than 25% of the delegates are residents of Canada
- you solicit orders for publications to be delivered to customers by mail or courier in Canada
- You operate a taxi/limousine service and your fares are regulated by federal or provincial laws, regardless of your annual revenues.
- You **do not** have to register if you are a non-resident who sells taxable real property located in Canada other than in the normal course of business.

How to register Business Registration Online (BRO)

Business Registration Online is a one stop, online, self-serve application that allows you to register for a Business Number, as well as for four program accounts: Corporation income tax, GST/HST, Payroll and Import/Export. **Register now** http://www.cra-arc.gc.ca/tx/bsnss/tpcs/bn-ne/bro-ide/rstrctns/menu-eng.html

It is the person or business entity that registers for GST/HST. **After you register** If you register by mail, the CRA will send you a letter confirming your business number (BN), program accounts registered, and a summary of the information you provided. If you register by telephone, online, or in-person you will be provided with your business number, and program accounts registered.