ALEXANDER HOLBURN

Business Corporations of Canada

Prepared By:

Alexander Holburn

604 484 1700 | info@ahbl.ca | www.ahbl.ca

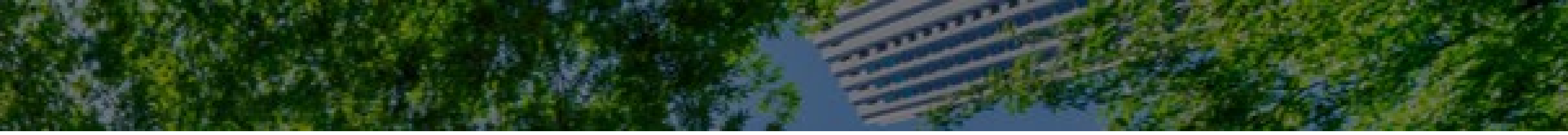
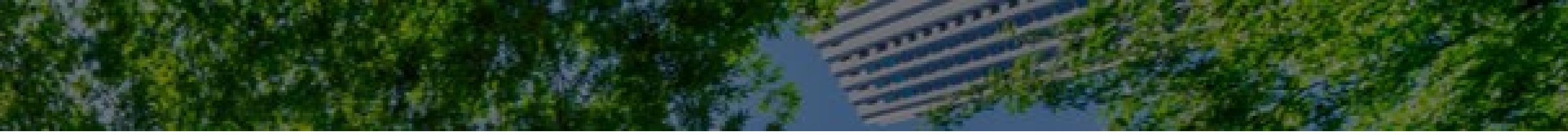


Table of Contents



Introduction

Alexander Holburn Beaudin + Lang LLP (**Alexander Holburn**) is pleased to present the *Guide to Business Corporations of Canada*, 2023 edition. The law in this guide is current to January 2023.

This guide is intended as a useful resource for businesses seeking to set up a corporation within Canada, and is not to be used as a substitute for or as a representation of legal advice. Should you require legal advice, we encourage you to contact one of Alexander Holburn's legal professionals who will provide you with information specific to your needs.

Please do not hesitate to reach out to Alexander Holburn with any questions or feedback.

Choosing your Business Structure

Last modified March 9, 2023

Sole Proprietorship

Sole proprietorships are primarily used in instances of a business with little or no risk of liability. While they are low cost, the law does not distinguish between the business and the individual – meaning that the sole proprietor is exclusively responsible for all obligations, debts and torts of the company. As such, income or loss from the business is blended with the income or loss of the individual in calculating personal tax, and the individual's personal assets may be liable to seizure in an action. The sole proprietor is not an employee (as one cannot contract with oneself), and there are no other parties involved, such as investors.

Legal Requirements

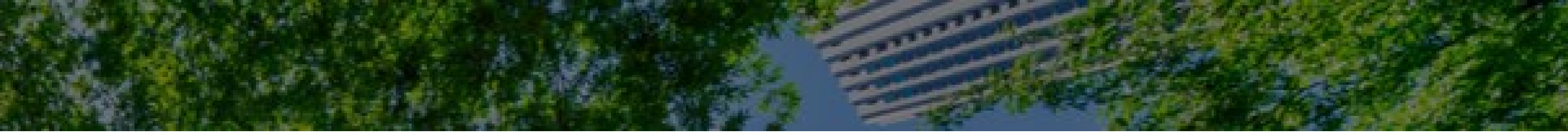
- Register name – file name declaration at BC Corporate Registry
- License business in accordance with local laws

Partnerships

Partnerships are created when multiple parties carry on business together. The parties are bound by a partnership agreement – a simple and inexpensive contract that sets out:

- Business and powers of partnership
- Capital contributions
- How distributions will occur
- Management
- Who can sign on behalf of the partnership
- Admission and expulsion of partners
- Wind-up

All partners may share in management of the entity, with the basic framework provided for in provincial legislation, such as the *Partnership Act* in BC. While there are "flow-through" tax-advantages in certain instances, it is important to note that all benefits and liabilities of the partnership business accrue directly to the partners such that each partner is directly liable:



i. to perform any contractual obligation, and
ii. for all torts committed by their partners.

As such, all of the partner's assets are fully at risk and creditors may pursue redress against one partner to the exclusion of the others. It is wise never to have the deepest pockets when entering into a partnership.

Legal Requirements

- Can come into existence as a matter of law, with no other formality
- Register name under relevant provincial legislation, such as BC *Partnership Act*
- Obtain business license

Limited Partnership (LP)

A limited partnership can be described as a hybrid of a partnership and a corporation, where the liability of the Limited Partners is limited to the amount of capital that they have contributed. They, however, have no management control, while the General Partner manages the business and shoulders all liability. Limited Partners are often arm's length investors who are seeking tax advantages and must be careful not to get involved in the business' operations such that they are deemed to be a General Partner. While a liability shield exists, income or losses from the business are allocated to a Limited Partner's own tax return just as it is to General Partners.

Legal Requirements

- Certificate filing under relevant provincial legislation, such as BC *Partnership Act*

Limited Liability Partnership (LLP)

Similar to a Limited Partnership, it can be described as a hybrid of a partnership and a corporation, but its structure provides to partners an added protection from liability. Partners are shielded from personal liability for:

i. debts of the partnership, and
ii. negligence of other partners,

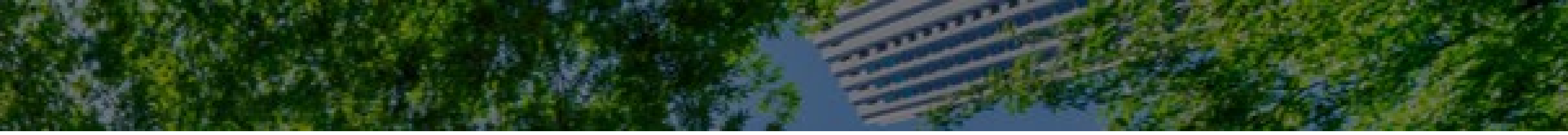
except to the extent of the partner's share in the partnership's assets. An LLP partner also remains personally liable for their own negligence, as well as any negligence of another partner or employee that the partner knew of or omitted and did not take reasonable action to prevent. LLPs have many of the same advantages as limited partnerships, with the added benefit that members can take on an active role in the business. Alexander Holburn, like many Canadian law firms, is a LLP.

Legal Requirements

- Certificate filing under relevant provincial legislation, such as BC *Partnership Act*

Unlimited Liability Corporations (ULC)

Unlimited Liability Corporations or ULCs are corporations in which shareholders are (in certain circumstances) jointly and severally liable to satisfy the debts and liabilities of the corporation. They are only available in the provinces of BC, Alberta and Nova Scotia. Unlike partnerships, shareholders



do not have a direct liability to creditors unless there is a liquidation insolvency and are usually incorporated entities themselves to maintain a liability shield between the ULC and the ultimate individual owner. ULCs have historically been used as a tax-advantageous vehicle for US investment in Canadian ventures as ULCs may be treated either as partnerships or “check-the-box” flow-through entities.

Corporate Subsidiary (Limited Liability Corporation)

Corporations are a separate and distinct legal entity that:

- Can sue and be sued
- Can enter into contracts
- Hold property in their name
- Have shareholders and directors

As such, members are exempt from personal liability for its debts, obligations or acts. Corporations benefit from several tax advantages unavailable to other entities, which we will discuss further below.

A subsidiary is a type of corporation in which the majority of its shares are owned by a parent corporation and thus effectively has control of it. While the subsidiary otherwise has all the classic hallmarks of a regular corporation, the distinction can become important within a tax context.

In this guide, we will focus primarily on the lifecycle of a Canadian Corporate Subsidiary or Corporation: from the early days of its incorporation until its winding up and the end of its corporate existence.

Creating a Corporation

All Canadian corporations other than Crown corporations are created by statute. There is both a federal and provincial power to incorporate, with little practical difference between provincial and federal incorporation today.

Incorporation

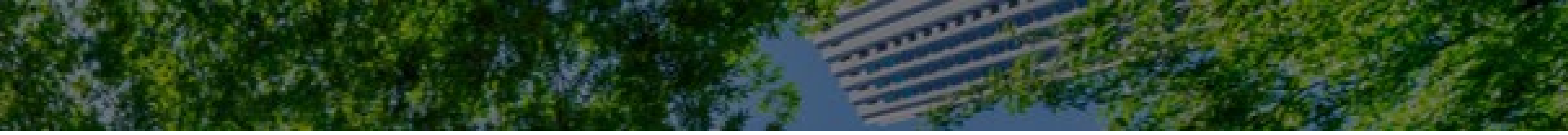
Step 1: Draft your Incorporation Agreement

Step 2: **Reserve your Name**

- Name reservation only required if not a numbered corporation
- Certain name requirements apply according to the relevant legislation
- Once a name request is approved, it is reserved for a number of days, which varies according to the jurisdiction of incorporation.
- Qualifies as a trade name under the *Trademarks Act* (Canada) and enjoys the protection of that legislation

Step 3: Draft Articles

- The corporate charter



- Sets out details including share capital (equity) of a corporation

Step 4: File Incorporation Application and Notice of Articles

- Federal Incorporation
    - Filed with Innovation, Science and Economic Development Canada (Corporations Canada)
- Provincial Incorporation
    - Filed with equivalent provincial or territorial government authority

Step 5: Apply for any permits and licenses your business may need

- Register as an extra-provincial or extra-territorial corporation in all other Canadian jurisdictions where you plan to do business
- May require additional licenses for certain regulated industries and/or municipalities in which business is conducted

Liability Considerations

- As a separate and distinct legal entity, corporations:
    - Can sue and be sued
    - Can enter into contracts
    - Hold property in their own name
    - Have shareholders and directors through whom they act

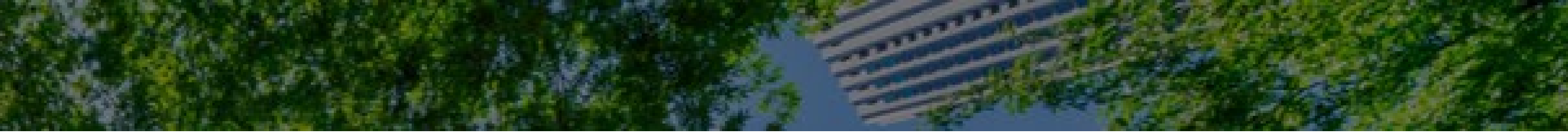
As a result, members are generally exempt from personal liability for the corporations debts, obligations, or acts.

Corporate Management

Corporate management, and thus a corporation's ability to act, is dictated by legislation – for federal corporations it is governed by the *Canada Business Corporations Act,* and for provincial corporations it is governed by the corresponding provincial incorporating statute. Control is split accordingly amongst the shareholders, directors, and officers of a corporation, as well as powers of delegation from shareholders to directors and from directors to officers. This can, however, be overridden by express provisions in a unanimous shareholder agreement, as governance of a corporation is an internal affair where majority rules.

Shareholders

- Minimum of 1 shareholder required for incorporation
- Akin to the general populace in the Canadian political system – they are capitalists who own an interest in a corporation represented by voting rights as well as shares (if it is a publicly traded company).
- While shareholders do not have direct managerial powers, they periodically elect those who do – the board of directors. A corporation is effectively governed by the majority rule of its shareholders.



- As well as an electoral function, shareholders additionally have a review function, in which they periodically review the performance of the elected directors and their appointed officers.

Directors

- Required for incorporation
- Elected by shareholders or by a unanimous shareholder decision
- Under some corporate statutes **a minimum of 25% of directors must be Canadian residents**
- The "ultimate decision maker", a Board of Directors manages or supervises the management of the business and affairs of a corporation, provide instruction for day-to-day matters, including operations, management of funds, and officer delegation.
- Limited by governing legislation, its articles, by-laws and any unanimous shareholder agreements
- Have a fiduciary duty to place the common benefit of the corporation before their own, as well as acting with honesty and in good faith.

Officers

- Not required for incorporation, but usually appointed nonetheless
    - Most common positions are president, treasurer, secretary, etc.
- Managed by the Board of Directors, who appoint their various authorities and responsibilities
- Responsible for the execution of day-to-day matters

Raising of Capital

The raising of capital is the responsibility of a corporation's Board of Directors. It is important to note that there is no minimum capital requirement in Canada, nor is there a requirement to open a local bank account prior to incorporation.

Three potential sources of funding exist to a corporation:

1. **Equity Financing:** Funding by the persons who own a corporation, either by way of the direct investment of funds by those persons, or alternatively, by those persons providing guarantees or similar comfort to third parties to encourage them to provide funding to the business.

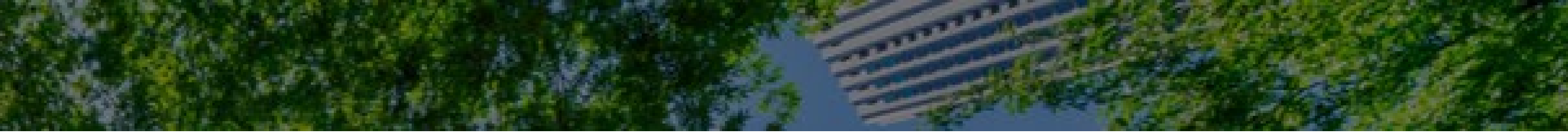
2. **Funding out of the surplus generated from its own trading activities:** Since the owners of the business may ultimately withdraw any surplus from a business, in effect, this second method is merely a subset of the first method of financing.

3. **External Financing:** Funding sourced by borrowing funds or obtaining credit from outsiders (creditors) who have no actual ownership interest in the business.

Share Capital

Civil corporations are often described as falling into one of two classes:

i. corporations with share capital, or,
ii. corporations without share capital.



For the most part, corporations with share capital are essentially profit-oriented enterprises, while corporations without share capital are non-profit in nature.

Corporations can have various classes of shares with different rights attached to them. The two most prevalent types of shares are:

1. **Common shares — these shares typically have the following rights:**
   i. the right to vote at shareholders' meetings and elect directors;
   ii. the right to receive dividends declared by the corporation;
   iii. the right to receive property of the corporation upon a dissolution of the corporation.

2. **Preference shares — these shares typically have the following rights:**
   i. usually no or limited right to vote at shareholders' meetings;
   ii. the right to receive dividends and return of property (upon dissolution of the corporation) before the common shareholders;
   iii. the possible right to receive fixed dividends on a periodic basis.

It should be noted that a corporation may attach various rights towards certain categories of shares and may create many categories of shares (for example, Preference Class A, Preference Class B, etc.). There are some restrictions upon what rights may be given or restricted and careful consultation of the jurisdiction's incorporating statute is recommended.

Taxation

Corporations are required to file annual tax returns with federal and provincial tax authorities, and have the following significant tax features:

- Incur assets and liabilities in their name only
- Are taxed on their income
- Expenses may be written off as deductions from the corporation’s income, including the payment of employees’ salaries, where it is taxed in the hands of the employee
- Corporations may, after paying taxes on their income, distribute some of this income to shareholders as a dividend where it is taxed at a reduced rate to reflect the fact that it has already been taxed at the corporate level.

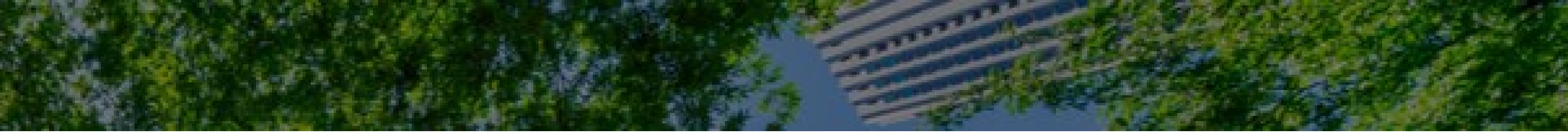
There are many potential tax advantages to incorporating your business, including:

1. **Small Business Tax Deduction**

   Under s. 125 of the *Income Tax Act*, a corporation may qualify to have its combined federal/provincial corporate income tax rate reduced to approximately 28%. In order to qualify, the following requirements must be met:

   - It must be a private Canadian corporation controlled by Canadian residents
   - Only income up to $500,000 qualifies for the Small Business Deduction
   - It must be an active business carried out in Canada: passive income does not qualify

   Note that with “associated” corporations – those where one corporation controls the other or they are both controlled by the same persons – the corporations share the Small Business Deduction collectively.



2. Income Timing

As tax is only paid once the owner of a business has received income in the form of a salary or dividend, businesses will often strategically retain their earnings wherein they are subject only to the lower corporate tax rate rather than paying them out immediately as a salary or dividend at which point they would be subject to the much higher personal income tax rate. They do this in order to continue to accrue interest on money that would have otherwise been paid out to taxes – this is called a “deferral advantage”.

The corporation may also choose to “accrue” employee bonuses for its current tax year but actually pay it out in the next taxation year. This means that the corporation would deduct the bonus from its current year's income while the employee recipient of the bonus would only be taxed upon the income in the year in which they receive it.

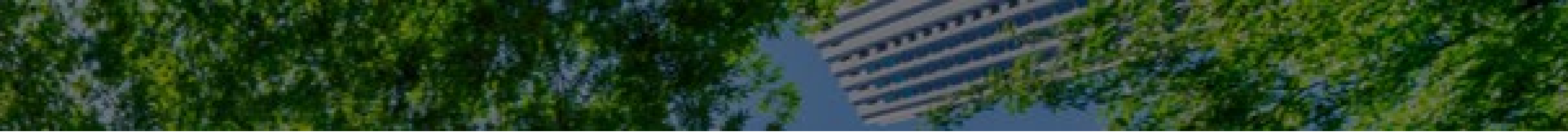
This tax planning technique is subject to three major criteria:

i. The bonus must be “reasonable and reflective of the services provided to the corporation” – otherwise, the tax benefit can be denied under s. 67 of *the Income Tax Act* (the *ITA*)
ii. A legal liability must be created. This means that there must be some firm legal obligation on the part of the corporation to pay such a bonus to the intended recipient. If it is not a firm legal obligation, then it may be construed as contingent liability or reserve, and pursuant to s. 18(1)(e) of the ITA, the tax benefit may be denied.
iii. The bonus must be paid out to the recipient within 180 days of the corporation's tax year.

3. Estate Freeze

An estate planning technique commonly used in family businesses in which the estate planners retain preferred shares fixed at the current value of the business, while the beneficiaries (usually the successors or children of the estate planners) accrue the increase in future value through their common shares. In this way, the estate planners can retain control of their corporation while their successors acquire its accumulated growth. Upon the death of the estate planner, their tax liability can be immediately quantified at the “frozen” value of their preferred shares, while the common shares of their successors will be taxed at the growth shareholders’ marginal tax rate and potentially be sheltered by their lifetime capital gains exemptions (assuming shares of the corporation meet the definition of the Qualified Small Business Corporation shares).

Remember that underlying the many tax benefits of a corporation is s. 245 of the ITA or the “general anti-avoidance rule”: where **any tax benefit that is found to be derived for the main purpose of obtaining a tax benefit with no legitimate business reason behind it will be denied**. Please contact Alexander Holburn, and our skilled legal practitioners can connect you with trusted tax practitioners to advise you on tax advantages for which you or your corporation might be eligible to benefit.



Tax Presence of a Corporate Subsidiary

Of import, Canadian resident corporations are not subject to branch profits tax on their worldwide income, only to the relevant provincial/federal tax, as well as a 25% withholding tax on the gross amount of dividends paid to non-resident shareholders. This “dual-layer” of tax at both the shareholder and corporate level can, however, be substantially reduced through relevant tax treaties: usually to 15% where such dividends are paid to beneficial owners who are entitled to benefits under the relevant treaty, and down to 5% in the case of beneficial owners of more than 10% of the voting shares of the corporation.

In contrast, Canada imposes a branch profits tax of 25% on the profits of a Canadian branch of a foreign corporation remaining after deducting the regular corporate tax and after taking into account reinvestment in Canada.

Distribution of Profits

Dividends

The shareholders of the corporation own the corporation through their ownership of shares of the corporation and can share in the profits of the corporation through the distribution of dividends.

It should be noted, however, that most jurisdictions prohibit directors from declaring and paying a dividend to shareholders where there are reasonable grounds for believing that:

- The corporation, after the payment, would be unable to pay its liabilities as they become due; or
- The realizable value of the corporation's assets would be less than the total of its liabilities and stated capital of all classes (for example, s. 38(3) OBCA).

Profit-Sharing Incentives

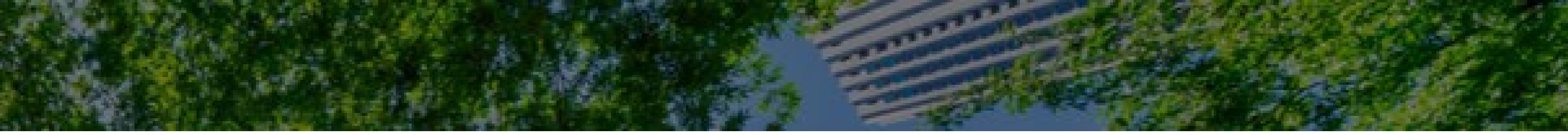
In addition, a prominent advantage of a corporation is its ability to provide profit-sharing incentives to its employees, in which they offer employees shares or options to buy shares of the corporation. It should be noted however that per s.110 of the *Income Tax Act*, these profits may be considered a taxable employment benefit.

Effective Fundamental Change

Corporate Arrangement and Reorganization

When a corporation would like to implement substantial internal change, it will likely affect the entitlements or rights of its shareholders, creditors or other interested persons. This can include such changes as:

- an amendment to the articles,
- an amalgamation of two or more corporations, or
- a liquidation and dissolution of a corporation.



What makes an arrangement unique is that it is subject to court approval, and a court may review and make orders regarding a proposed arrangement. The arrangement **may also have to be approved by special resolution of the shareholders of a class or series of shares**, if the arrangement, had it been contained in an amendment to the articles, would have required such a vote.

Amalgamation

One way in which a corporation may reorganize is through amalgamation, in which two or more corporations are consolidated to continue as a single new and enhanced corporate entity. The property and liability that were once that of each amalgamating corporation are now the collective property and liability of the amalgamated corporation.

Amalgamation is governed separately and distinctly either by the *Canada Business Corporations Act* (federally) or by relevant provincial legislation, such as the *Business Corporations Act* in BC.

In order to amalgamate, you must create an amalgamation agreement that sets out details such as:

- the names of the amalgamating parties
- the directors,
- the treatment of shares,
- proposed bylaws and
- the subsequent management and operation of the amalgamated corporation.

The amalgamation agreement must also set out **the basis upon which and manner in which holders of the issued shares of the amalgamating corporations are to receive money or securities of the amalgamated corporation/body corporate**. It is important to note that an amalgamation agreement, upon being signed, is both legally binding (similar to a contract) and is a matter of public record.

Amalgamation additionally requires the notification and subsequent approval of the shareholders of each of the amalgamating corporations. If a shareholder dissents to the amalgamation, it may be their right to be paid the fair value of their shares, such as in s.185 of the OBCA.

Finally, articles of amalgamation must be drafted in the required form as dictated by the relevant legislation. These essentially contain the same content as the articles of incorporation explained above and are submitted to the Director who issues a certificate of amalgamation as well as any other documents as required by relevant legislation.

The End of Corporate Existence

The end of a corporation's existence can be brought about in several ways:

Voluntary Dissolution

Dissolution may be done either voluntarily or by court order.

Voluntary dissolution requires a 2/3 vote in favor by a corporation's shareholders – aka "by special resolution". Once the special resolution has passed, the corporation maintains its existence and powers but ceases to carry on its undertaking insofar as is required for winding up. This includes settling all debts, liabilities and obligations owed to third parties, as well as distributing all remaining property of the corporation to its shareholders according to the relevant share conditions.

In addition, the following must be submitted:

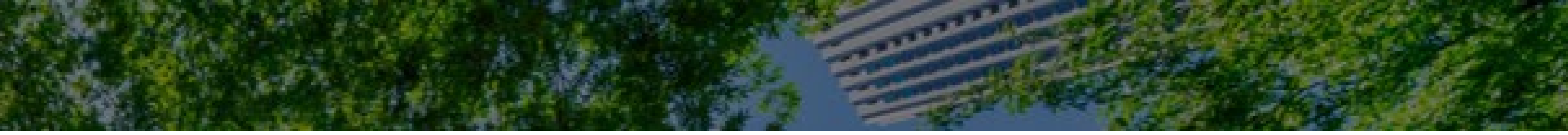
- articles of dissolution
- a consent letter from the relevant tax authority that confirms the corporation has no taxes owing, and
- a required filing fee.

Winding Up or Liquidation

Similar to dissolution, winding up may also be done either voluntarily or by court order. The only difference between a voluntary winding up and a voluntary dissolution is that rather than being handled by the shareholders it is handled by a neutral liquidator. This may be preferable when:

- it is desired to remove control from directors or officers to prevent disputes or
- to limit the commencement of proceedings and attachment of executions against the corporation.

Involuntary winding up is very similar to voluntary winding up, except that each step of the process is closely supervised by the court. This may be preferable when it is expected that the process of winding up is likely to be disputed and may possibly give rise to litigation.



ACCREDITATIONS

This guide is authored by **Loren D. Mallett** and **Afshaan Jiwaji Kapasi**, lawyers at Alexander Holburn Beaudin + Lang LLP (“**Alexander Holburn**”), who have a deep understanding on the topics researched above. They, along with Sarah E. Richmond, Manager of Research Services at Alexander Holburn, and the following students: Anika Garlick, have conducted extensive research on the topic of businesses seeking to set up a corporation within Canada.

KEY CONTACTS

LOREN D. MALLETT
PARTNER

EMAIL lmallett@ahbl.ca
TEL 604 484 1750
Vancouver
View bio

Loren Mallett is the leader of both the firm’s Corporate / Commercial and Intellectual Property + Technology Practice and a member of the firm’s Health, Corporate Finance + Securities, Franchise, Aviation and Maritime practices. Loren is a registered Canadian Trade-mark Agent and is also the supervising lawyer responsible for the firm’s SmartStart™ Program.

AFSHAAN JIWAJI KAPASI
ASSOCIATE

EMAIL ajiwaji@ahbl.ca
TEL 604 484 1730
Vancouver
View bio

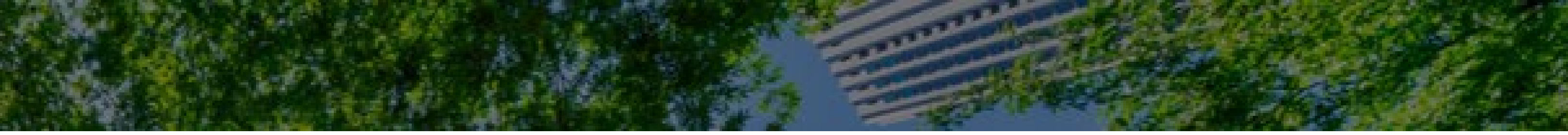
Afshaan is a member of Alexander Holburn Beaudin + Lang LLP’s Corporate/Commercial and Intellectual Property + Technology practice groups. She advises on a wide range of business matters, including the implementation of corporate reorganization and restructuring. Afshaan enjoys building long-term relationships with clients and supporting them across their business’ life cycle. She is committed to providing knowledgeable and practical advice across a breadth of industries.

ABOUT ALEXANDER HOLBURN

As a leading full-service Canadian law firm, Alexander Holburn provides clients with thoughtful and practical legal advice nationally and internationally. With over 100 experienced lawyers and two offices – Vancouver and Toronto, we serve the legal needs of companies of all sizes, across a wide range of areas including litigation, dispute resolution, insurance, and business law. In addition, our international affiliations allow us to serve clients on a global scale.

For 50 years, we've been trusted advisors to our clients. We have earned a reputation for excellence in insurance, construction disputes, transportation – aviation, road, rail and maritime, as well as the healthcare sector. Our lawyers are repeatedly recognized by *Benchmark Litigation Canada, the Best Lawyers in Canada*, the *Canadian Legal Lexpert Directory*, *Chambers Canada* and *Who’s Who Legal: Canada*.

For more information, please visit ahbl.ca.



Disclaimer

The information presented in this publication is for general purposes only and is not intended to create an attorney-client relationship. It is not a substitute for seeking legal advice tailored to your specific situation. Alexander Holburn Beaudin + Lang LLP assumes no liability for any actions taken or not taken based on the content of this publication.

Please note that in some jurisdictions, this communication may be considered "Lawyer Advertising." Any prior results mentioned do not guarantee a similar outcome in future legal matters.