BUSINESS ORGANIZATIONS

By Sven Milelli

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A wide variety of legal arrangements may be used to carry on business activity in Canada. Some of the more commonly used arrangements are corporations, limited partnerships, partnerships, trusts, co-ownerships, joint ventures and unlimited liability companies.

The selection of the appropriate form of business organization will depend in each case upon the circumstances of the investor, the nature of the activity to be conducted, the method of financing, income tax ramifications and the potential liabilities related to the activity.

Generally, one of the first issues faced by a foreign entity contemplating carrying on business in Canada is whether to conduct the business directly in Canada as a Canadian branch of its principal business or to create a separate Canadian entity to carry on the business. The following issues should be taken into consideration before making this decision:

- the treatment of Canadian business income for tax purposes in the proponent's home country;
- the advisability of isolating the assets of the principal business from claims arising out of the Canadian business;
- whether one or more parties will own the Canadian enterprise;
- criteria for the availability of federal, provincial and municipal government incentive programs; and
- Canadian tax considerations.

A foreign entity carrying on a branch operation in Canada must be registered in each of the provinces in which it carries on business. In addition, foreign entities must complete many of the same disclosures and filings with the federal and provincial governments as are required of Canadian corporations.

Of the forms of business organization referred to above, the corporation with share capital is the entity most often used to carry on commercial activities in Canada. Unlike the limited partnership, partnership, trust, co-ownership or joint venture, the corporation is a legal entity separate from its owners. The shareholders do not own the property of the corporation, and the rights and liabilities of the corporation are not those of the shareholders. The liability of the shareholders is generally limited to the value of the assets they have invested in the corporation to acquire their shareholdings. In addition to the advantages of limited liability, the securities of a corporation are generally more readily marketable. As a result, corporate shares (and debt instruments) are often seen as more attractive investments than units in partnerships or joint ventures. In some situations, there may also be tax advantages to using a corporation.

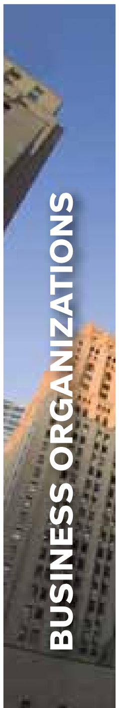
CORPORATE SHARES (AND DEBT INSTRUMENTS) ARE OFTEN SEEN AS MORE ATTRACTIVE INVESTMENTS THAN UNITS IN PARTNERSHIPS OR JOINT VENTURES.

Unlike a corporation, a partnership is not a separate legal entity, but a relationship that exists between the parties who carry on business in common with a view to profit. Partners share in the profits, losses and net proceeds on dissolution. The most significant advantage of a partnership is that it is permitted to "flow through" losses to its partners that may, subject to certain rules in the *Income Tax Act* (Canada), be used as deductions against the partners' other income. The most significant disadvantage of a general partnership is that each of the partners is personally liable for the liabilities of the partnership, and their personal assets are exposed in the event the partnership assets are insufficient to cover such liabilities. The exposure of a partner to liability can be minimized by using a limited partnership rather than a general partnership. In a limited partnership, the liability of a limited partner is limited to the extent of its investment in the partnership, so long as it takes a passive role in the business and governance of the limited partnership.

In each case, the selection of the form of business organization best suited to carry on business in Canada will depend entirely on individual circumstances.

Where a corporation is the preferred vehicle for carrying on business within Canada, consideration must be given to the appropriate jurisdiction for incorporation. The nature of a corporation's particular undertaking (e.g., banking) may be such that it falls within the exclusive legislative purview of either the federal or provincial governments, with an attendant requirement to incorporate under a specific statute. However, corporations not specifically subject to such legislation may be incorporated under the federal laws of Canada or under the laws of any one of the provinces or territories.

The principal federal corporate statute is the *Canada Business Corporations Act* (CBCA), which is modeled on modern business statutes



in the United States. Most provinces and territories in Canada also have their own corporate legislation, based largely on the CBCA. There are minor differences between the various federal and provincial corporate statutes that can affect the choice of jurisdiction of incorporation, depending upon the particular circumstances.

THERE ARE MINOR DIFFERENCES BETWEEN THE VARIOUS FEDERAL AND PROVINCIAL CORPORATE STATUTES THAT CAN AFFECT THE CHOICE OF JURISDICTION OF INCORPORATION, DEPENDING UPON THE PARTICULAR CIRCUMSTANCES.

A foreign investor will find the following features of Canadian corporate legislation of interest:

- Under the CBCA, 25% of a Canadian corporation's directors must be "resident Canadians" (i.e., individuals resident in Canada who are either Canadian citizens or Canadian permanent residents). Directors' residency requirements for corporations established under the laws of the provinces or territories differ from one jurisdiction to another. Several provinces and territories have no residency requirements at all.
- The board of directors of a Canadian corporation must consist of at least one individual, but can have an unlimited number of directors.
- Each director must be an individual person, and a director may not appoint an alternate to serve in his or her place.
- Directors are generally subject to a number of liabilities and obligations under corporate law, as well as under a range of other federal and provincial laws, including those relating to the environment, tax, securities, pensions and employment.
- The shareholders of a Canadian corporation can, in most cases, enter into a "unanimous shareholders' agreement" to restrict the powers of the board of directors. To the extent the powers of the directors are so restricted, the liabilities and obligations of the directors will generally be transferred to the shareholders.
- Single shareholder corporations are permitted and directors need not hold shares in the corporation.
- Minority shareholders of a Canadian corporation have significant statutory rights and remedies and eliminating minority shareholders can often be difficult and costly.

BUSINESS ORGANIZATIONS

- The board of a Canadian corporation must approve the corporation's financial statements annually and present them to the corporation's shareholders.
- Generally, there is no requirement to file a Canadian corporation's financial statements with a government body, except in the case of a public company.
- The requirement that the corporation's financial statements be audited varies by jurisdiction; in most cases, it is possible for the corporation's shareholders to consent to exempt it from the audit requirement, except in the case of a public company.
- The identities of a Canadian corporation's shareholders are not a matter of public record and a corporation is not obliged to disclose the names of its shareholders, unless it is a public company, a Québec private company or a company carrying on business in Québec.
- Meetings of the board of directors and, in certain limited circumstances, the shareholders of a Canadian corporation need not take place in Canada.
- Resolutions of directors or shareholders may be passed by a written instrument signed by all of the directors or shareholders, as the case may be, in lieu of a meeting.
- The statutory books and records of a Canadian corporation, including those maintained in electronic form, must be kept in Canada.

United States businesses coming to Canada may, in certain circumstances, use unlimited liability companies (ULCs) as a vehicle for their business activity in Canada because of the favourable treatment afforded to ULCs as "flow-through" entities under U.S. tax law. U.S. advice should be obtained.

In addition, certain anti-hybrid provisions in the *Canada-United States Income Tax Convention* (1980) (U.S. Convention) should be considered, as in certain circumstances they may eliminate the tax benefits associated with such entities or give rise to adverse tax consequences without proper tax planning. See Taxation.

FOR MORE INFORMATION, PLEASE CONTACT:

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