Queen's Law Clinics
Business Law Clinic

Business Law Playbooks

Part 1 – Choosing the Appropriate Business Vehicle for Your Business Idea

Prepared by the Queen's Business Law Clinic in collaboration with Queen's Partnerships and Innovation

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About Queen's Partnerships and Innovation

Queen's Partnerships and Innovation ("QPI") aims to advance research, innovation, and knowledge mobilization to strengthen Queen's local, national, and global impact. QPI provides faculty, students, post-doctoral fellows, and other members of the Queen's community with a variety of services and resources to facilitate strategic initiatives and research partnerships. QPI is also proud to work with external organizations (both industry and not-for-profits) to connect them with expertise, resources, and incubation support.

About Queen's Business Law Clinic

The Queen's Business Law Clinic ("QBLC") is a free legal clinic which was established in 2009 to provide year-round legal services to a wide variety of individuals, businesses and non-for-profit organizations in southeastern Ontario. The QBLC aims to help individuals and businesses who would otherwise have difficulty affording legal counsel, while providing Queen's Law students with practical legal experience working with clients, while instilling in them the values of community service and the pro bono tradition. The QBLC is proud to have contributed to the economic growth and social well-being of Kingston and its surrounding communities by helping entrepreneurs, small businesses, charities and not-for-profit organizations with their legal needs.

Why do you need a Playbook?

For many people with little or no previous business or entrepreneurial experience, understanding the relationship between law and business – and how it may affect the success or failure of their business idea – is a very important step. In this series of Playbooks, we seek to provide general information on the legal concepts that should be considered by the entrepreneur starting out their business venture.

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1 Choosing the Appropriate Business Vehicle for your Business Idea

When starting your business, one of the biggest decisions you will face is choosing an appropriate business vehicle. This decision may have a long-lasting effect on your business: how profits are shared, how much you pay in taxes, the amount of paperwork you will have to deal with each year, your personal liability as a business owner, and your ability to raise additional capital to expand your business.

Whether you plan on operating a for-profit or not-for-profit business, it is important to understand the business vehicle options available which will enable you to make an informed decision. Many start-up founders believe incorporation is the most appropriate vehicle for their business idea – just because that is the way others have done it. However, the choice of an appropriate business vehicle is business and client specific. Your individual circumstances, short and long-term business goals, business idea, and potential for growth and liability, among other factors, should be considered before choosing a business vehicle.

While there are a few considerations that every business owner should bear in mind when deciding on the appropriate business structure, the three major issues are (1) liability, (2) taxation, and (3) record-keeping. Other factors which should be considered are listed below:

- Will you be operating this business on your own or in collaboration with others?
- Will there be any potential liabilities arising from the use of your products or services?
- Who has the decision-making power –solely your responsibility, or a joint responsibility?
- Do you have sufficient initial working capital to cover the start-up costs of the business? If not, how do you plan to raise your initial working capital? Some possibilities include: contributions from family and friends, personal contributions, and grants or loans from financial institutions.
- Are you interested in keeping the start-up costs low?
- Do you need flexibility in your business structure?
- Will you be interested in exploring tax benefits for your business?
- How do you plan to distribute the profits and losses incurred by the business?
- Will you need to raise additional capital for the business in the near future?

- Will you be operating the business in Ontario only or do you foresee the opportunity to expand your business to other provinces or internationally?

- What is your long-term goal for the business – do you anticipate that your business will grow, and would you like to make room for future growth?

- Will you be able to maintain and keep up to date all records required to be kept by a corporation in compliance with regulatory requirements?

- Are you or your business partner(s) residing in Canada?

- Do you plan to operate your business to make a profit, or are you interested in setting up a not-for-profit organization?

- Will your proposed activities be carried out for the public benefit and do they fall within any of these categories – relief of poverty, advancement of education, advancement of religion, or advancement of other purposes beneficial to the community?

- If you plan to operate a not-for-profit business, how do you intend to raise funds to carry out your proposed activities? Will you accept donations and do you intend to provide tax relief to your donors?

1.1. Forms of Business Vehicles

1. Sole Proprietorship
2. Partnerships (General, Limited, and Limited Liability Partnerships)
3. Corporations – For-Profit and Not-For Profit Corporations
4. Registered Charities, Non-profit (Unincorporated) Organizations
5. Social Enterprises
6. Joint Ventures and Trusts

1.1.1. Sole Proprietorship

Are you planning to start your business on your own? If yes, you may structure your business as a sole proprietorship. A sole proprietorship is the simplest form of business vehicle. It requires no formalities to create and grants the owner of the business sole control and decision-making abilities. Sole proprietors are required to register a business name under the Ontario *Business Names Act* ("*BNA*") only if the business name is different than the sole proprietor's name. There are tax implications attached with this type of business vehicle – profits and liabilities from the sole proprietor business are deemed to be personal income of the proprietor and taxed accordingly. The owner is also personally liable for all financial obligations of the business.

1.1.2. Partnerships

Are you planning to start your business with others? If yes, a partnership arrangement may be suitable for your business. Similar to a sole proprietorship, no formal registration is necessary when setting up a partnership. A partnership is legally created when two or more persons carry on business together in order to make profit. Unlike sole proprietorships, partnerships are governed by specific provincial legislation - in Ontario, we have the Ontario *Partnerships Act* (the "*OPA*"). The *OPA* sets out default rules which govern a partnership relationship. However, it is prudent for partners to enter into a partnership agreement. This agreement is a contract between the partners that sets out the major terms of the business relationship including: the division of revenue and partnership property, contribution share of each partner, expenses, right to make management decisions, risks and tasks for each partner, and the process of dissolving the partnership. There are also tax implications for using this business vehicle – just like a sole proprietor, partners are required to declare their share of the business' income and expenses as their personal income and are taxed accordingly.

A partnership, also like a sole proprietorship, is required to register its business name under the *BNA* if the business name is not composed of the names of the partners.

1.1.3. Corporations

Are you looking for protection from liability and the ability to raise capital for your business? If so, incorporation is likely the appropriate vehicle for your business. You can incorporate under either the *Canadian Business Corporations Act* ("*CBCA*") or the *Ontario Business Corporations Act* ("*OBCA*"). For example, Indigo Books & Music is incorporated under the *OBCA* while Shoppers Drug Mart is incorporated under the *CBCA*. The QBLC can assist you in deciding which option is best for you if you choose to incorporate.

A corporation is treated as an independent legal entity, separate from its owners. It has its own legal identity and can sue or be sued. Under its legal identity, a corporation can carry on business, buy and sell property, borrow money from various sources and incur liabilities. A corporation also owns its own assets. The corporation is managed by its directors and officers, however the ultimate control of the corporation rests in the hands of the shareholders. Shareholders own specific rights to the corporation through their ownership of shares.

A corporation also has a perpetual existence, until it is dissolved in accordance with regulatory requirements. While incorporation protects you from liability, it also means that a corporation is required to comply with more stringent regulatory and tax requirements. The drawbacks to incorporation for start-ups include higher start-up costs and annual filing obligations. The process of incorporating a company is more expensive than forming a partnership or a sole proprietorship. You will also need to obtain legal, tax, and accounting advice from professionals which increases the general costs of incorporation. A corporation can be for-profit or not-for-profit. We will discuss each form of corporation in subsequent publications.

1.1.4. Charities and Non-Profit (Unincorporated) Organizations

Registered Charities

These are charitable organizations, public foundations, and private foundations that are created and resident in Canada. Their main goal is to use their resources for charitable activities. The

Heart & Stroke Foundation, for example, is a registered charity. Their charitable purposes must fall into one or more of the following categories:

- The relief of poverty (e.g. food banks, soup kitchens, and low-cost housing units)
- The advancement of education (e.g. colleges, universities, and research institutes)
- The advancement of religion (e.g. places of worship and missionary organizations)
- Other purposes that benefit the community (e.g. animal shelters, libraries, and volunteer fire departments)

Some of the major attractions of becoming a registered charity include the ability to issue official donation receipts and enjoy income tax exemptions. You must apply to the Canada Revenue Agency ("CRA") to obtain charitable status before becoming a registered charity. Please note however, that not all organizations operating as charities are registered charities – in other words, you can carry out charitable activities, but are not or do not qualify to be registered with the CRA as a registered charity. These unregistered charities cannot provide donors with tax receipts.

Non-Profit (Unincorporated) Organizations

Some associations, clubs, and societies provide services that are exclusively for social welfare, civic improvement, pleasure, recreation, or another purpose. So long as the services they provide do not include generating profit, such organizations are referred to as non-profit organizations. One advantage of the non-profit organization is that it may qualify as a tax-exempt non-profit organization if certain CRA requirements are met. Note that you cannot be classified as both a charity and a non-profit organization. You can only meet one definition.

1.1.5. Social Enterprises

These are organizations with both business and social goals. Their main objective is to produce goods and services sold for profit with the aim of using the proceeds of sale to further the achievement of social and environmental goals. Operating as a social enterprise allows public benefit organizations to raise funds through alternative means in order to better fulfill their organization's mandates. It provides an opportunity for the non-profit sector to be more sustainable and less reliant on donations and grants from individuals and government sources. In 2012, Ontario established the Office for Social Enterprise ("OSE") which focuses on supporting social enterprises in Ontario. A social enterprise can be set up in different forms including, but not limited to, a cooperative, non-profit society, civil society association or credit union. They can be structured as a for-profit or not-for profit organization.

1.1.6. Joint Ventures and Trusts

Joint Ventures

Joint ventures are short-term, project-specific, contractual relationships. This type of contract is called a joint venture agreement. The parties' obligations in a joint venture is within the agreement itself and these obligations can vary depending on the project. Joint ventures do not have any specific governing legislation. Note that the parties to the joint ventures have to comply with their respective governing legislation (e.g. *OPA*, *CBCA*, etc.).

Unlike partnerships, parties in a joint venture are not agents of one another, and they treat any income they earn and any expense they acquire from a project entirely separately. There is also no partnership property or jointly owned property. The assets of each party coming into the project remain the assets of that party.

Trusts

A trust company is created when a person (settlor) transfers property to another (trustee) to hold for the benefit of a specific person or a class of people (beneficiaries). This relationship allows a trustee to carry out business on behalf of the beneficiaries. A trust is not strictly a legal entity, but it is treated as one for tax purposes. A trust agreement governs the relationship between the parties involved and the rules that the trustee and the beneficiaries must follow. The trustee owes a fiduciary obligation to the beneficiaries, meaning the trustee must act in the best interest or to the benefit of the beneficiaries rather than themselves.

1.2. Quick Chart Summaries - Advantages and Disadvantages

Type of Entity	Advantages	Disadvantages
Sole Proprietorship	• Easy and inexpensive to set up • Regulatory burden is very light • Direct control of decision making • Enjoys tax advantages in certain scenarios • No profit/loss sharing – owner bears all the benefits and risks alone	• Unlimited liability • Income from the business is taxed using the personal income tax rate • Lack of continuity – business dissolves upon the disability or death of the sole proprietor • Raising capital from traditional sources may be difficult

Partnership	• Fairly easy to set up – can be set up informally or upon entering into a partnership agreement
	• Inexpensive to set up
	• Start-up is quick.
	• Start-up costs can be split with partner(s)
	• Equal decision-making powers with partner(s)
		• All partners are jointly liable for any debts and liabilities incurred by the firm or each individual partner
		  ○ Partners are "jointly and severally liable" for the actions of each partner
		  ○ This can be mitigated by purchasing insurance which can be expensive

	• Equal share of profits and risks of the business • Some tax advantage in certain scenarios (e.g. partners may avoid potential tax liability by "rolling over" their assets to the partnership under s.97(2) of the *Income Tax Act*, subject to certain requirements ○ A rollover shifts the tax liability to the partnership instead of the contributing partner)	• A person may continue to be liable for losses and debts of the partnership which were accrued when the person was still a partner even after leaving the partnership or upon their death • The partnership interest held by a partner forms part of a partner's personal assets, thus exposing it to the personal liabilities incurred by the partner outside of the partnership
Incorporation	• Limited liability for shareholders • Ability to raise equity capital for the business • Continuous existence and transferability • Indemnification of directors • Tax benefits such as the Small Business Deduction, Lifetime Capital Gains Exemptions for Canadian-Controlled Private Corporations and the ease of estate planning	• Initial costs of incorporation • Annual filing requirements • Residency requirements for directors (*CBCA*) • Dissolving a corporation is more complex than other business structures • Directors' actions are restricted by their fiduciary duties and duty of care owed to the corporation • Disclosure requirements of directors • Potential of directors' personal or statutory liability
Registered Charities	• Ability to issue official donation receipts to donors • Exempt from paying income tax • Eligible to receive gifts from other registered charities • Increased credibility in the community • Exempt from GST/HST and may be eligible for only a partial rebate (usually 50%) of any GST/HST paid	• Costs of incorporating and the attendant annual record-keeping requirements • Must have a minimum of three directors, who must meet the definition of an eligible director under the legislation • Directors owe a measure of personal liability to the charity • Must comply with more stringent legislative and CRA reporting requirements

Not-For-Profit (Unincorporated) organizations	• Tax exemption – may pay taxes on property income or capital gains • More flexibility on the structure of the association • Fewer regulatory requirements (e.g. no minimum spending requirement, no registration process required, no annual filing requirements)	• Not a separate legal entity – cannot enter into contracts under its own name; it cannot sue or be sued, it cannot hold property • Not governed by any statute • No limited liability – Members are personally liable for the acts and liabilities of the association
Social Enterprise	• Easy to raise capital – from goods and services, access to grants • Easier to garner support from the public • Flexible business structure – could be a for-profit corporation or a not-for-profit corporation	• In Canada, only a Community Contribution Company ("CCC") in British Columbia or a Community Interest Company ("CIC") in Nova Scotia can be formed specifically for social enterprise • No special tax treatments
Joint Ventures	• Project specific • Regulatory burden is generally light • Parties' rules are flexible • Minimal working capital required for start-up • Not formed by implication • No income or property sharing	• Limited outside opportunities • Lack of continuity for your business once your project comes to an end • Uneven division of work • Can be difficult to raise capital on your own
Trusts	• Allows a settlor to direct the allocation and use of assets without needing to directly manage or oversee the assets	• Is only a legal entity for tax purposes

	Start-up costs	Regulatory burden	Individual control of decision making	Tax benefits	Individual share of income	Exposure to liability	Ability to raise capital	Continuous existence	Legal duties
Trust	X	X	X	X	n/a	X	n/a	X	X
Joint Venture	X	X	X	X	X	X	X	n/a	n/a
Social Enterprise	X	X	X	X	n/a	X	X	X	X
Not-For-Profit Organizations	X	X	X	X	n/a	X	X	X	X
Registered Charity	X	X	X	X	n/a	X	X	X	X
Incorporation	X	X	X	X	X	X	X	X	X
Partnership	X	X	X	X	X	X	X	X	n/a
Sole Proprietor	X	X	X	X	X	X	X	n/a	n/a

Legend:
X = Low
X = Medium
X = High

1.3. Conclusion

Ensure that you take the time to consult with legal, accounting, and tax professionals before making a decision on the appropriate business structure for your business. Choosing the optimal organizational structure that best enables your objectives and goals will save you a whole lot of time, energy, and money which you can instead spend on growing your business idea.