

INCORPORATING A COMPANY

There are a number of possible forms of business organization or ownership in the Province of Nova Scotia. The most common forms are Proprietorship, Partnership and a Limited Company.

PROPRIETORSHIP

A Proprietorship is a business operated and controlled by a single individual. In this form of business enterprise, any income of the business is treated for tax purposes as personal income of the proprietor. The principal disadvantage of this form of business organization is that liabilities arising from the operation of the business are the direct personal responsibility of the individual business owner. The principal advantage of a proprietorship is that it is the most inexpensive form of business organization.

PARTNERSHIP

A Partnership is an enterprise in which two or more individuals carry on business together and agree to share profits and losses of the business. For tax purposes, the income of a partnership is allocated to the individual partners on the basis of the agreement which they have reached between themselves. In a partnership, as in a proprietorship, the partners are directly personally responsible for all debts and other liabilities of the business, including those incurred by another partner. If this form of business enterprise is chosen, it is highly advisable to have a written Partnership Agreement, which establishes the details of the relationship, including such matters as responsibilities, control, division of income or losses, and procedures for amending or terminating the agreement between the partners.

LIMITED COMPANY

In many cases, a lawyer will recommend the incorporation of a business enterprise to take advantage of the many benefits of this form of business

organization and ownership. A Limited Company is a legal entity separate and distinct from its individual owners or "shareholders." The company is responsible for its own debts, assets and obligations. Incorporation is accomplished by a legal procedure which requires the filing of constitutional documents, including a "Memorandum of Association" and "Articles of Incorporation." Additionally, officers and a board of directors are selected and, often, a Shareholders' Agreement is entered into by the Shareholders.

ADVANTAGES OF INCORPORATION

The principal advantage of incorporation is that the owners of the company have limited protection from claims of creditors in the event of a business failure. The liability of a shareholder of an incorporated company is normally limited to the amount which he has invested or has agreed to invest in the company. Creditors can normally claim only against the assets of the company itself to satisfy their claims. Thus, subject to the comments below concerning Personal Guarantees, the personal assets of the company owners are not at risk in the event of a business failure, as they are with a Proprietorship or a Partnership.

The advantages of this "limited liability" are not as absolute as many people believe. Normally, most of the business' obligations will be to its bank, trust company or credit union, and these institutions almost invariably require a "personal guarantee" of the principals of the company. Thus, in the event of default by the company, the debt would become an obligation of the individual shareholders who have personally guaranteed the debt. An incorporated company may involve some financial advantages as a result of special tax rules which apply to corporations. An incorporation may also be a prerequisite to obtaining certain types of federal government assistance. It may also enhance the business' image. Incorporation has the additional advantage of providing a form of business organization which, in theory at least, can go on forever, notwithstanding the death of the original business owner or owners. Upon the death of any single shareholder or director, the company may carry on, managed by the surviving members. Ownership in a corporation is much easier to transfer than is ownership in a Proprietorship or Partnership. An additional advantage of incorporation is that a limited company may raise capital more easily than other types of businesses, simply through the issuance of shares.

DISADVANTAGES

Although they are normally outweighed by the advantages, there are certain disadvantages to the incorporation of a business enterprise. These should be discussed with your lawyer before proceeding. A limited company can be much more costly to set up and more complicated to maintain than other types of business enterprises. There are very strict government regulations regarding filing of annual statements and payment of registration fees. The initial set up of a limited company involves a large amount of legal work and may involve substantial accounting fees. Thus, the total cost of setting up a limited company may be a deterrent to some very small enterprises. The assistance of a lawyer is essential when incorporating a company and one would be well advised to also seek the advice of an accountant to ensure that any relevant tax consequences have been considered. In addition to the government regulated annual registration procedures in order to maintain the existence of a limited company, there are certain internal matters which must be attended to on a regular basis including election of officers and directors, shareholders' and directors' meetings, and the maintenance of a corporate minute book.

CONCLUSION

A lawyer will be able to advise you as to the form of business organization which best suits the goals and needs of your business. Your accountant will be able to advise you regarding the relevant tax consequences of whichever form of business organization you may be considering. The Landry McGillivray ADVISOR is intended to give general information only so that you will be aware of some of the issues which you should consider when contemplating the organization of a new business enterprise. For specific advice on your business, you should seek advice from your Landry McGillivray lawyer.