

PROPRIETORSHIP, PARTNERSHIP AND INCORPORATION

By Jay Chauhan

LEGAL FORMS OF BUSINESS ORGANIZATIONS

There are three basic ways in which a business organization can exist, namely a sole proprietorship, a partnership, and a corporation. A sole proprietorship is where one person using his own name or any other name, conducts business. In a partnership, there are two or more persons carrying on a business activity under their own names or the name of a partnership. Incorporations are for legal purposes and entirely separate, legal entity created by law and can be used by a single person or more persons together.

SOLE PROPRIETORSHIP

If a one-man operation uses a name different than his own, he must register this name under the Partnerships Registration Act at 555 Yonge Street, Toronto. The form is relatively simple, and it can be done by the individual at a minimal cost of \$10.00. In case of financial difficulties, the individual remains personally liable and his home and personal assets can be used to satisfy a judgement. The registration lasts for five years, and must be renewed at expiry.

It is possible for a sole proprietor to call his business by a name such as "ABC Company". The fact that the word "company" is used does not provide any extra legal protection as incorporation does, and this is commonly misunderstood by many. For tax and legal purposes, the sole proprietor is the same as the individual, even if he uses a different name.

PARTNERSHIP

Where two or more persons are engaged in a business activity, it is known as a partnership. Like a sole proprietorship, they must register the business name if names other than their own are being used to conduct the business activity. The same provisions of registration apply and each partner must sign this form and such declaration lasts five years. Here again, if the word "company" is used at the end of the name, it provides no extra protection, like incorporation.

Each partner remains fully liable for the debts of the partnership, regardless of which partner incurred the liability. In case of financial difficulties, the judgement can be enforced against each and every partner and if any one partner does not have any monies, the other partner who has the property and personal belongings and a house, he would have to meet the liability.

Each partner is liable too pay tax on his share of the profit made. For legal purposes, the liability is full, despite the percentage of partnership interest.

It is very desirable for the partners to have a partnership agreement, which sets out the basic terms of the partnership arrangement, including what business will be conducted, profit and loss sharing formula, whether the partnership will continue the death of a party, where the account of the partnership will be maintained, and if any partner is to be employed full-time, what salary he may expect. If a partnership agreement is not provided, the provisions of the Partnership Act will apply, and in such events, the partnership will dissolve, for example, on the death of a partner. The partnership agreement also would provide for a formula by which upon disagreement, a party could withdraw from the partnership. Where no agreement is provided, any partner could simply register dissolution of partnership and terminate the partnership arrangement. Legal advice is desirable in drafting a partnership agreement.

In case of failure of a partnership to register a business name, no action can be brought by the partnership to sue a defendant, who fails to pay them.

INCORPORATION

Incorporation is often called a limited company. When a corporate body is formed, it creates a separate legal person, and has a different legal existence than the person or persons who formed that legal entity. A corporation may be identified by using the words "limited", "incorporated", or "corporation".

The word "limited" correctly describes the idea of limited liability, when a corporation is formed. Unlike the sole proprietorship and partnership when a corporation is formed, the individual or the persons forming it are only liable for the amount of investment made by them, in the corporation. In case of financial problems arising, the judgment can be enforced only against the assets and property owned by the corporation, and the assets of the individual and his home cannot be touched. This is the most important reason for forming a corporation, as most people wish to protect their personal assets against the risks of the business.

A corporation offers a variety of tax planning benefits. The most common benefit derived is the possibility in a small company, of splitting the income between the husband and the wife. Under the attribution rules of the Income Tax Act, the income derived by the wife is deemed to be that of the husband, but where a corporation is formed, and the wife works for the corporation, it is legally possible for the husband to divert a certain amount of income to the wife, provided that she is doing some work in the company.

A corporation is also in effect, an estate-planning vehicle. By issuing common shares to children in trust, the growth value of the shares of the corporation can be transferred to the children without incurring inheritance taxes under Succession Duty Act, and Income Tax Act.

A corporation can be formed either under the Canada Business Corporations Act, or the Provincial Legislation, and in Ontario, the Ontario Business Corporations Act. A federal company is desirable where it may, in the future, have head offices in various provinces. A federal company does not require extra-provincial licenses to operate in different provinces. It does require, however in Ontario, a Licence In Mortmain. This license is required when the company owns or rents property in Ontario. The Ontario corporation does not require such license to operate within Ontario, but may require extra-provincial license to operate in other provinces, except Quebec.

It is now possible for a one-man person to form incorporation and he may be the sole director also the sole shareholder in that company. Where there are more shareholders, a difficult decision to make is the proportion of shares owned by each shareholder in the company. A 51% control usually gives the right to such shareholders to elect the board of directors and accordingly, exercise effective control of the operations of the business.

The directors of a company are responsible to the shareholders and must hold an annual general meeting each year, even if there are only one or two shareholders, who might be the same persons as the directors.

Where there are two or more shareholders in a company, a buy-sell agreement or some shareholders agreement is very desirable. Such agreement can set out how a party can withdraw as a shareholder, or how the shares will be disposed of upon death or disagreement. This agreement is commonly ignored by shareholders until a dispute arises, when it is usually too late.

Competent, legal advice is desirable in forming a company, as the procedure is not simple as the registration of partnership or proprietorship is.

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PARTNERSHIP MEMO

REGISTRATION REQUIREMENTS

Where two or more persons are engaged in a business activity, it is known as a partnership. They must register the business name if names other than their own names are being used to conduct the business activity. Partners must sign the declaration form. Registration is valid for 5 years. If the partnership is not registered no action can be brought by the partnership against a debtor for recovery of money until the partnership is registered.

If you want me to assist you in the preparation or registration or partnership please let me know.

LIABILITY

Each partner remains fully liable for the debts of the partnership, regardless of which partner incurred the liability. In the event of financial difficulties, a judgment can be enforced against each and every partner. If any one partner does not have nay money, the other partner who has the property and personal belongings and a house would have to meet the liability. Using the name company for a partnership does not eliminate personal liability.

TAX

Each partner is liable to pay tax on his share of the profit made. Expenses are deducted from the profit and the share of net income of each partner is declared on his tax return. Partnership can have a different fiscal year than the calendar year.

AGREEMENT

It is very desirable for the partners to have a partnership agreement. It should set out the basic terms of the partnership arrangement, including what business will be conducted, profit and loss sharing formula, whether the partnership will continue on the death of a party, where the account of the partnership will be maintained, and if any partner is to be employed full-time, what salary he may expect. If a partnership agreement is not provided, the provisions of the Partnership act will apply. Without an agreement the partnership would dissolve on the death of a partner. The partnership agreement should also provide for a formula by which in the event of disagreement a party can withdraw from the partnership. Where no agreement is provided, any partner could simply register dissolution of partnership and terminate the partnership arrangement. Legal advice is desirable in drafting a partnership agreement.

INCORPORATION

Incorporation is often referred to as a limited company. When a limited company is formed, it creates a separate legal person, and has a different legal existence. A corporation may be identified by the use of the words "limited", "incorporated", or "corporation".

The word "limited" correctly describes the concept of limited liability of a corporation. Unlike the sole proprietorship and partnership when a corporation is formed, the individual or the persons forming it are only liable for the amount of investment made by them in the Corporation. In the event of financial problems arising, the judgment can be enforced only against the assets and property owned by the corporation, and the assets of the individual and his home cannot be touched. To ensure this, personal guarantees should be avoided, if possible. The most important reason for forming a corporation is to protect personal assets against the risks of the business.

It is now possible for a one-man person to form a corporation and he can be the sole director and also the sole shareholder in that company.

A corporation is more expensive but desirable for the protection of personal liability.

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