A LAWYER'S REALISTIC GUIDE TO INCORPORATION

What Every First Time Entrepreneur Needs to Know About Starting a Corporation in Toronto

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(Barrister & Solicitor)

WELCOME

Hey Dude!

Thank you for taking the time to download this Guide.

I am a Canadian lawyer.

I grew up in Kensington Market, went through a gazillion years of school, started my legal career at a national business law firm, spent three years as in-house counsel in Singapore, thankfully made it back to Canada, and now run my own firm in Yorkville. (In case you were wondering, I am married and have a young son.)

In total, I have been practicing law for more than ten years now. Over the years, I have had the privilege of working with a range of clients, including quite a number of entrepreneurs.

I like working with entrepreneurs. Entrepreneurs are people who want to make something happen, they are passionate about building something, and they are ready to turn their dream into a reality. I like working with people like that. It makes my work more enjoyable.

Last year, when we first got locked down, I was, of course, kinda shocked. As time goes on, I started noticing how the streets in Yorkville and the shops around Bay / Bloor are packed with young guys who are doing delivery work. I started reflecting on how fortunate I am (my law firm remains pretty busy, for better or worse) and thinking about how I can give something back to those around me...

WELCOME (2)

...

Even though we are supposedly "locked down" a lot of young guys (and girls) are still out there hustling.

A lot of people in the GTA are still working really, really hard. If you are reading this Guide, you are probably one of those people. I hope you are. You may or may not be delivering take-out, but I hope you are working hard.

That is why I created a law firm blog with credible, reliable information for first-time entrepreneurs. There is a lot of information on the internet, but - news alert - some of it might not be of the highest quality.

As a lawyer, I have a responsibility to serve the public good. I grew up around lawyers (again, for better or worse, lol), but I realize that many guys did not have that kind of exposure coming up. That is why the first set of posts on my law firm's blog was aimed at being a resource for guys (and girls) who are just getting into running their own business.

The blog digged-in to basic information about the legal vehicles someone in Toronto can use to structure a business. You could think of it as a crash course on business law basics. This Guide is gonna take things up a notch.

Because I want you to have all the information you need to make your own decision, this Guide has ended up being kinda long. ...

WELCOME (3)

This Guide has ended up being longer than similar publications from, say, Shopify. (Nothing against Shopify LOL. Again, I am trying to give you all the information you need.)

This Guide will help you understand whether a corporation is the right structure for your business. I hope you are ready to read the whole thing.

Here is what you can expect:

The next section will go over the three most popular vehicles for carrying on business in Toronto, or anywhere in Canada.

The second section will help you understand why a corporation is treated as a legal person and what that means, especially the need for multiple actors who work as a team.

Then, sections 3 and 4 will review the key benefits and disadvantages associated with incorporation.

The Guide will even show you the two steps that an entrepreneur MUST KNOW AND FOLLOW when choosing to incorporate.

t's all good, man. Let's do this.

...

MATTHEW A J LEVINE
Barrister & Solicitor


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SECTION 1

Toronto Business Vehicles

As you weigh up the pros and cons of incorporation, remember you have other options for your business's legal structure.

The best vehicle really does depend on the specific facts around you and your business.

Sole Proprietorship

A sole proprietorship is a business owned and operated by a single individual.

A sole proprietorship can do business under the owner's name or under a trade name that the owner has chosen (subject to certain limitations.)

The rules for a sole proprietorship will vary slightly depending on the province or provinces in which you intend to carry out business. The following goes through three potential advantages with particular attention to our situation in Ontario.

One of the most significant advantages of a sole proprietorship is that setting up and administering the business is comparatively easy. In Ontario, for example, you simply fill-in an online form, pay a de minimus registration fee, and register for HST.

It is also going to be less expensive to operate a sole proprietorship, as compared to, for example, a corporation. For instance, in 2020, the fee to incorporate electronically in Ontario was $300 and you will may also want to provide at least one name search report, which will cost approximately $15. Moreover, the record-keeping and meeting requirements associated with running a corporation will result in costs.

Another key feature is that the sole proprietorship itself does not pay income tax. Instead, as a sole proprietor, you declare your business income on your personal income tax form.

The flip side of these advantages is that the sole proprietorship does not enjoy a separate legal identity, which means personal liability.

KEY POINT

A sole proprietorship is a business owned and operated by a single individual. It can do business under the owner's name or under a trade name that the owner has chosen (subject to certain limitations.)

A sole proprietorship is less expensive (cheaper) than incorporation.

B. Partnership

A business partnership is a traditional way of organizing a business venture where ownership, and sometimes management, is split between two or more persons.

In fact, three types of business partnerships are possible in Canada. They are a general partnership, a limited partnership, and a limited liability partnership. The general partnership ("General Partnership") is the most common type, and it is our focus here.

As opposed to a corporation, a General Partnership, is not a separate entity from its owners. In this respect, a partnership is similar to a sole proprietorship. A partner in a General Partnership may become personally responsible for all of the liability flowing from the business venture, including the conduct of the other partners.

Another key feature of a partnership relates to taxes, and this point flows from the fact that the partnership is not a separate legal entity. Therefore, the partnership does not pay income tax. Instead, profit or loss, as the case may be, "flows through" from the partnership to the partners.

The partners then pay tax on this income on their individual tax return. Also, because the partnership does not file for or pay its own income tax, the associated administrative fees may be less than in the case of a corporation.

Another feature flows from the partnership's lack of a separate legal identity. The partnership does not enjoy indefinite existence. Upon the death of a partner, a partnership will cease to exist. This is sometimes called the mortality of the partnership. On the other hand, a corporation continues to exist irregardless of its founders or other shareholders' status.

KEY POINT

Three types of business partnerships are possible in Canada. A General Partnership is the most common type, and it is our focus here.

A General Partnership is not a separate entity from its owners. A partner in a General Partnership may become personally responsible for all of the liability flowing from the business venture, including the conduct of the other partners.

A General Partnership is fundamentally a legal relationship. As with most types of legal relationships, it is best to get things in writing.

In a sophisticated business partnership, a written agreement is negotiated and then signed between all of the partners. This document is known as, not surprisingly, a partnership agreement. There will, of course, be at least two partners; and, there could be more than two partners. Furthermore, the partners might be natural persons, i.e., people, or legal persons, such as corporations.

The partnership agreement will set out each partners' contribution to the partnership, i.e., for use in the underlying business venture. The partnership agreement will also set out how decisions are to be made, the duties of each partner, and how any profits will be distributed as well as other details of how the business will operate.

KEY POINT

A business partnership is sometimes the right option. Are you actually looking for help with a new or existing business partnership?

Learn more >

C. Cooperative

The least common business structure for our purposes, a cooperative is a business that is owned and controlled by an association of members. The members are a group of people (or businesses) who both provide a good or service and purchase that good or service. Think Dairy Farmers in southwest Ontario

In fact, I gotta be straight forward with you: there are some guides to incorporation out there that talk about a cooperative as an option worth considering for aspring entrepreneurs. This really makes no sense.

I guess its true what they say: you get what you pay for!

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I understand that as an entrepreneur you need need reliable corporate and contract law services. That is why I've invested time and tech in streamlining my firm's processes for delivering legal services. The result is that me and my team are quick and efficient.

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Regardless of where in the digital value chain your start-up business is located, you can rely on my team of experienced legal professionals to deliver corporate and commercial law services that match your needs.

Incorporation

Using the best in cloud-based technology, we help you establish, organize, and maintain your corporation in good standing. From cap tables to share certificates, we do it all and we do it digitally.

Contracts

We help you with all your contract drafting, negotiation, and management needs. Looking to develop a customized set of contract templates that your business can plug and play - we love document automation and are here to help.

Fractional GC

From process building and contract management to getting support with ad hoc inquiries, my team can bring on the legal expertise your company needs, when it needs it.

Fund Raising & Exits

High growth companies almost always burn capital. When to raise external funding is an important topic that should be discussed with experienced counsel. Once you achieve profitability you will again want to discuss the timing and structure of a potential exit.

SECTION 2

What is a Corporation, really?

Under Canadian law, a corporation is a legal person that has a separate entity from its shareholders, directors, and officers.

There are three leading theories about why the law grants corporations a distinct legal identity.

According to the property aggregation theory of corporate law, the corporation is primarily an extension of the shareholders. Although the business may be carried on in the corporation's name, it remains the "property" of the shareholders. According to this theory, the person-hood of the corporation is no more than a benign legal fiction.

According to the Entity Theory, the corporation is a distinct institution, and it is not reducible to the shareholders' property. The shareholder is just one of several positions in the corporation. On the entity theory, these roles include not just the shareholders, the directors, and the officers but also employees, customers and suppliers. On this view, the legal personality that law confers is not a pure fiction but a key fact. Amongst the classical theories of corporate law, this theory comes closest to the stakeholder theory.

The final theory is that of a Nexus of Contracts. A corporation's most salient feature on this theory is that it has quid pro quo relationships to shareholders, lenders, suppliers, employees, and other agents. Shareholders provide the corporation with investment capital and in exchange they get dividends, voting rights, and right to assets upon winding up after liabilities are paid. Accordingly, the shareholders relationship to the corporation is fundamentally contractual in nature. Likewise, the relationship between the directors and officers is also seen to be contractual albeit a contract of agency.

To put things very simply, all of these theories agree that
• a corporation is a legal person, and
• corporation is created by the combination of applicable legislation and the initiative of one or more persons.

But, there is significant debate about the true character of the corporate entity. The three classical theories are often applied by Canadian courts.

KEY POINT

A corporation is a legal person. Once you incorporate, your business automatically has multiple actors with distinct roles and responsibilities: the shareholders, the directors, and the officers.

[1] (Our blog post also previewed the stakeholder theory of the corporation, which is increasingly widely recognized.)

No matter which theory you prefer or a particular court may prefer, there is a consistent consequence. You need to be aware of this consequence if you are thinking of putting your time and money into a corporation.

What is the consequence?

The corporation is comprised of multiple actors with specific roles.

Yes, it is possible for a single person to act as shareholder, director, and officer of a corporation. However, this is very much the exception. And, even if a single natural person is occupying all three roles he (or she) is still acting in three different roles.

Each role comes with unique rights and unique responsibilities. Accordingly, he needs to know which role he is acting in when he takes a certain decision or action.

This is especially important if the corporation intends to issue shares to outside investors or even just bring in debt financing. Even if outside investment is not anticipated, it is essential to appreciate the distinction between shareholders, directors, and officers (i.e. officers are senior management).

But, here is the real punchline: multiple actors are not a problem with the corporation. This is not a 'glitch in the code'.

Specialization of roles a fundamental feature of the corporation, and especially of a successful corporation. It is a significant reason why incorporation is such a tremendously powerful structure for profitably conducting business: the corporate form brings together multiple actors, with specific skills and experience, who are all incentivized to work towards a shared goal.

KEY POINT

Multiple actors are not a 'glitch in the code' of the corporation.

Multiple actors are a fundamental feature of the corporation, and especially of a successful corporation.

The corporate form brings together multiple actors, with specific skills and experience, who are all incentivized to work towards a shared goal. This is a significant reason why incorporation is such a tremendously powerful vehiclefor profitably conducting business:

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SECTION 3

The Benefits of Incorporation

The corporation's separate legal identity results in several significant advantages.

You may already know that the the corporation's separate legal identity results in several significant advantages. This seciton looks at some of those advantages in detail.

First, separate legal identity results in limited liability for the owners, i.e. the shareholders. Put very simply, the most a shareholder can lose is whatever he has invested into the corporation. Even if the corporation racks up millions of dollars in debt or causes a major accident that results in legal liability, the shareholders of the corporation will not typically be personally liable.
Limited liability is a major advantage of the corporate form. It applies to both financial and legal liabilities.

Another key feature of a corporation is the expansive range of activities that a corporation can participate in. Canadian law adopts a liberal approach to corporate acts: a corporation is a legal person. It can enter contracts and own property. It can sue or be sued. It can lend money, borrow money, buy insurance, and so on. (If the founder of a corporation today wants to limit its activities, they can do so in the Articles of Incorporation.)

The corporate structure also facilitates multiple owners. And It is relatively easy to transfer ownership by selling shares either to another businessperson or back to the corporation. Corporate shares are also significant if you intend to raise money from investors. (Without incorporation, the business will simply not be able to issue shares to potential investors.)

Separate legal identity also has tax consequences. In Canada, the simple truth is that corporations' tax rate is lower than the tax rate on individuals. The government also makes various tax reductions available to small businesses only if they are incorporated. The flip-side of this is that there needs to be money in the corporation in the first place (which means that the money has not gone in to the pocket of the shareholders.)

There is one more advantage associated with separate legal identity: a corporation has no expiry date. Instead, a properly maintained corporation may enjoy perpetual existence. Furthermore, a corporation’s business enjoys limited name protection in the jurisdiction where it is registered. The combined significance of indefinite existence and corporate name protection is that the corporation creates a platform against which a powerful, and long-lasting brand can be created.


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SECTION 4

The Drawbacks of Incorporation

Incorporation creates on-going administrative and management responsibilities that may be challenging.

The single biggest disadvantage of incorporation is that it creates extra responsibilities, and extra costs.

The extra responsibilities include the need for documented shareholders and directors meetings as well as maintaining a minute book. The responsibilities, in fact, really kick-in when it comes to, you guessed it, paying the tax man.

Let's look at one of the legal responsibilities that comes about *after* your business is properly incorporated: the minute-book.

Once the corporation is incorporated, it has on-going requirements relating to, for example, record-keeping. The corporate minute book provides a tangible example (The minute book is the responsibility of the corporation’s director or directors.)

Furthermore, if you intend to seek out external investment in the corporation, a credible investor will expect to have the minute book reviewed by his (or her) law firm as part of his (or her) due diligence.

What is a minute book? Typically it is a binder with the following sections:

1. Corporate Articles
2. Corporate By-laws
3. Directors Register
4. Forms Filed
5. Notices and Resignation
6. Officers Register
7. Resolutions and Minutes
8. Share Certificates
9. Shareholders Ledger
10. Shareholder Register
11. Transfers Register
12. Debt Obligations Ledger
13. Shareholder Agreement
14. Individuals with Significant Control Register (for CBCA corporations)

This is obviously quite a lot of paper. The minute book is a requirement under both federal and provincial corporate law. However, it is now possible and increasingly common to maintain a digital minute book.

Let's consider just point number 7. This refers to all Director Resolutions, Shareholder Resolutions, Minutes of a Directors Meeting, and Minutes of a Shareholders Meeting. As such, the maintenance of a corporate entity can be challenging for first-time entrepreneurs.

There are also purely financial disadvantages associated with incorporation.

First, in terms of tax, incorporation means you will not be able to claim any of the personal tax credits that you otherwise would as a non-incorporated business.

Second, in terms of raising money to finance the business, the word incorporation does not guarantee that you will be able to borrow money. In many cases, a bank or other financial institution will look through the corporation and insist on a personal guarantee for any business loan.

Finally, while on the subject of disadvantages, we need to consider the possibility of conflicting priorities between the shareholders, directors, and officers.

The extra responsibilities, in fact, really kick-in when it comes to, you guessed it, paying the tax man.

In Canada, we have the Canada Revenue Agency (CRA). Every year a corporation needs to prepare its financial statement and supporting documentation. This is then reviewed by an accounting firm so that corporation's tax return can be filed with the CRA.

Of course, handling these responsibilities also results in cost whether in terms of professional fees or simply trying to do things by yourself. There are also fees imposed by the government for registration and annual reporting, which need to be included in the business' budget.

Reviewing your goals against the above disadvantages is a prudent step to take. It can help you decide if incorporation is the right move for your business right now.

Regardless of how you start, as your business grows, the time will hopefully come when you need to seriously consider incorporating. A good rule of thumb is to look at whether the business is generating surplus profits and you, as a business owner, have more revenue than you need to cover personal expenses.


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SECTION 5

The Two Steps of Incorporation

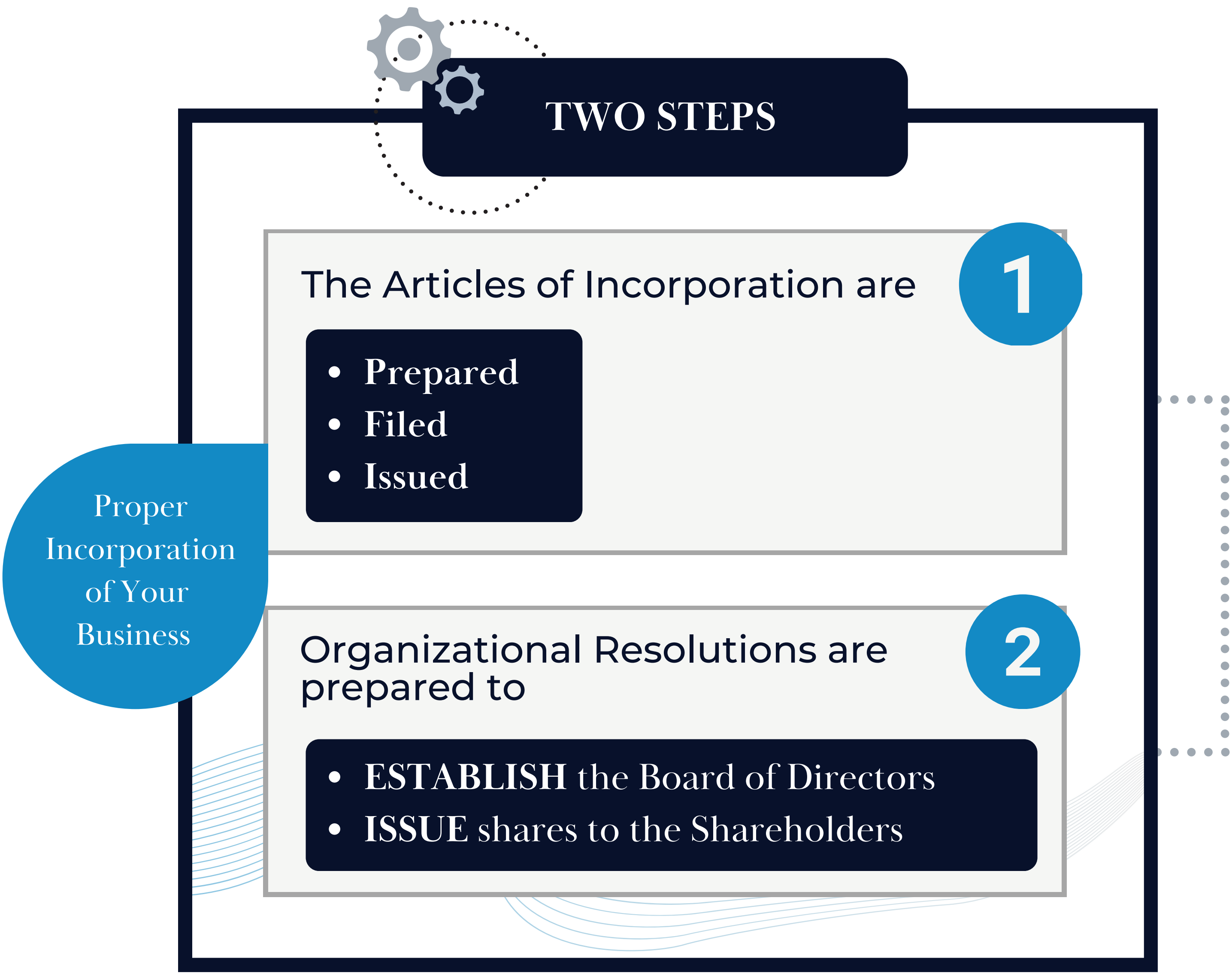
There are two necessary steps for properly incorporating your business in Toronto.

What you must understand — whether you incorporate provincially or federally — is that there are two substantive steps that must be executed to properly incorporate a business in Toronto.

By executing both steps, you can ensure that your corporation is properly formed and that your liability is thus legally limited. Failure to execute the two steps means that you are really just pretending to incorporate. If the business does grow, the confusion created by pretending to incorporate will, sooner or later, need to be fixed.

Really?

Yes



Two Substantive Steps for Proper Incorporation

I know the above sounds harsh, so let me explain in a little more detail.

We will break break down the two substantive steps in a minute. First, based on experience, it is important to clarify about how things go off the rails.

As you are reading this Guide, you may have also seen ads from anonymous websites claiming that you can incorporate for as little as $100. Understandably, that kind of claim is alluring: why get professional assistance with incorporation when it can done for a tenth of the cost?

It is a fair question. And, let me be frank: this Guide is *not* trying to convince you to use any particular service. This Guide is a 100% Complimentary resource that we created to provide credible, reliable information. If you want to use a cut-rate 'hack', that is your business.

What's more, for some guys, those anonymous websites are actually good enough. As with everything, it depends.

What does it depend on?
It depends on

- you;
- your business; and,
- to some extent, on the specific service provider (there are one or two who are not better than the rest.)

let's start with you. Do you have experience with corporate management? Do you feel comfortable reviewing, creating, and finalizing corporate documents that are legally binding?

Even more important is your business. If your business has only one shareholder, then it is not unreasonable to incorporate the company yourself. You may need assistance later on as the business grows, but so long as their is only one shareholder, you cannot do too much damage by going the do-it-yourself route in the beginning.

KEY POINT

If you have experience with corporate management and feel comfortable reviewing, creating, and finalizing corporate documents then you might consider acting as the Incorporator and completing Step One.

What you need to understand is that the anonymous sites are reducing a set of steps to a single document - the articles of incorporation. The result is that they do not complete the incorporation process: they only complete step one.

At the end of the day, its up to you.

You already know that you need to create and reserve a corporate name, right? This process varies slightly depending on whether you are incorporating federally or provincially, but it is really not rocket science. Think of name reservation as a 'pre-step'.

Step 1

The essential thing you must understand (I am repeating myself - lol) is that a properly incorporated business has executed both of the following two steps

1. The Articles of Incorporation are prepared, filed, and issued by the Ministry.
2. Organizational resolutions are prepared to, for instance, establish the board of directors and issue shares to the shareholders.

The anonymous websites usually just plug into the government's system and complete the first step only. The result is that you get the Articles of Incorporation. You could do this yourself by logging in to the government website and having the Articles issued without any third party involvement.

You have essentially paid $100 or $200 in exchange for ... nothing.

In fact, from the perspective of on-going legal compliance it can be worse than nothing.

In most cases, these anonymous websites fail to tell you that they have only completed Step 1 of the Two-Part Process. They fail to tell you that if you don’t complete Step 2 after receiving the Articles of Incorporation, your corporation is deficient and could eventually be dissolved by the Ministry.

Step 2

So what is Step 2?

Step 2 is sometimes referred to as 'organizing the corporation' or 'corporation organization'.

Simply put, Step 2 is the stuff that lawyers end up doing, sooner or later.

When filing Articles of Incorporation in Step 1, the government only requires the name of the corporation, the registered head office and the name of the director.

But, the new corporation is still required to complete the incorporation process in Step 2 by electing directors, appointing officers and issuing shares to shareholders.

Still more precisely, in Step 2: resolutions are prepared that organize the management of the new corporation. These resolutions also confirm the central tenets of the new corporation, as a matter of law.

KEY POINT

Step 2 is the stuff that lawyers end up doing, sooner or later.

After receiving the Articles of Incorporation, the new corporation should still to complete Step 2 by electing directors, appointing officers and issuing shares to shareholders.

What information do these resolutions contain? The resolutions typically confirm:

- Appointment of the director or directors;
- Appointment of the officer or officers;
- issue shares and share certificates to shareholders, specify the amount of their shareholdings, class of shares, and percentage of ownership
- confirm fiscal year end
- confirm the corporation’s bank
- confirm corporation’s advisors (accountant and solicitor)
- provide consent for the corporation to exempt itself from the requirement to prepare audited financial statements
- indemnify directors and officers.
- Provide for the creation of an official minute book that houses all of the corporate records.

All of this is required by law.

By having a professional advisor, such as a lawyer, assist with Step 2, your new corporation will start out with everything it needs, such as the following, to do business smoothly:

- Digital Minute Book
- Articles & Certificate of Incorporation
- Corporate By-Laws
- All necessary Director & Shareholder Resolutions
- Share Subscription & Share Certificates
- Necessary Registers & Ledgers

SECTION 6

Final Words

Incorporation is a powerful vehicle.

Like they say: with great power comes great responsibility.

Hey, thank you for reading all the way to the end of this guide.

It took my team and I quite a long time to put this thing together, so I definitely appreciate that someone read it (lol). I also want to say a big thank you.

Seriously, I put this guide together because I like working with entrepreneurs and I want my law firm to provide value to entrepreneurs. This guide is just a first step, tho. We have lots of more exciting initiatives still to come.

Like I said at the beginning, or I should have said, there is no sales pitch. There is no obligation with this guide. I am just sharing my experience. Like they say: advice is freely shared and may be freely ignored :)

Bottom line, incorporating is not rocket science. If you are ready to go into business you should be ready to incorporate properly - are you ready?

It's all good, man.

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COURTESY OF

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