

Forms of Business Organization in Ontario

by Peter A. Cusimano, B.Sc., LL.B.

[Law Office of Peter Cusimano](#) • Toronto, Ontario, Canada

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The Key to Success

Almost everyone at some point has an idea to start their own business. Starting your own business can be one the most rewarding experiences. However, without careful planning you will most certainly have great difficulty. Whether your plan is to run a part-time business out of your home to help you earn extra income or your plan is to start the next Fortune-500 company, you must address some legal matters to start your business and keep it running smoothly.

Methods of Carrying On Business

Before you can start, you must consider the legal form that you wish to carry on business. There are several common methods of carrying on a business for profit. These are:

1. Sole Proprietorship,
2. Partnership,
3. Corporation,
4. Franchise,
5. Limited Partnership,
6. Co-Ownership,
7. Licence,
8. Joint Venture.

This article focuses on the legal characteristics of the first three methods.

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Which Method is Best for You

Which method is appropriate for your situation requires careful consideration of among other things: your goals, your current financial situation, the nature of your business, expected sources of financing, number of people involved and the relationship of the parties. Consultation with an accountant is advisable to consider the income tax implications of the various forms of business.

1. SOLE PROPRIETORSHIP

A sole proprietorship exists whenever an individual carries on business for the individual's own benefit without involving the participation of other individuals, except as employees, and without using one of the other forms of business. The individual is the sole owner (hence, the name sole proprietorship). The sole proprietorship is the simplest form of carrying on business.

(i) Advantages of the Sole Proprietorship:

1. The sole proprietorship involves minimal legal formalities and registration requirements to begin and maintain.
2. The sole proprietor has total decision-making authority.
3. The sole proprietor enjoys all the benefits (income) of the business.
4. All of the assets (equipment, inventory, property, etc.) of the business are owned by the sole proprietor (unless they are purchased by way of a loan).

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(ii) Disadvantages of the Sole Proprietorship:

1. The sole proprietor is personally responsible for all liabilities (losses, debts, expenses) of the business. Therefore, the sole proprietor is personally responsible for all contracts and financial responsibilities of the business and for all actions of the business's employees.
2. If there are any lawsuits against the business the sole proprietor will be personally liable for any judgment against the business. As such, the sole proprietor's personal assets such as his/her automobile, house, bank accounts are at risk of being seized by anyone obtaining judgment against the business.
3. Income or loss from the business must be included with the sole proprietor's other sources of income during the year. As a result, the sole proprietor may be subject to paying more income tax than if another method of carrying on business is used. However, in some cases, the ability to apply losses to the personal income of the sole proprietor may be an advantage to the sole proprietor especially if there are other sources of income.

(iii) Licences

Some business may require a licence in order to carry on business. For example, licences may be required by electricians, plumbers, restaurants, taxi cabs, convenience stores, driving schools, employment and personnel agencies, motor vehicle dealers, real estate brokers, securities dealers, and various other activities.

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(iv) Business Name Registration

If a sole proprietor wishes to carry on business using a name other than his/her own, then the business name must be registered with the Ministry of Consumer and Commercial Relations. Registration must be made when the name is first used and registration is for a period of five years and may be renewed. Failure to register a business name is against the law and may result in a summary conviction. In addition, anyone who has failed to register cannot maintain a proceeding (i.e.: defend or commence a lawsuit) in any court in Ontario in respect of that business without leave (i.e.: permission) of the court.

You can register any name you choose, subject to a “passing off” lawsuit preventing you from using the name because it is too similar (in spelling or pronunciation) to someone else’s name or trademark.

2. PARTNERSHIP

A “partnership” exists when two or more persons (individuals or corporations) carry on business in common with a view to a profit. The members of a partnership are called “partners”. A partnership is like a sole proprietorship except that instead of one proprietor, there are many proprietors. However, the existence of more than one proprietor creates many complications. The persons who are partners are referred to collectively as a “firm”, and the name which the business is carried on is called the “firm name” or “partnership name”. Common examples of partnerships are lawyers and accountants. Hence, the terms “law firm” and “accounting firm”. However, many small businesses also use this method of carrying on business. In addition, there are many tax advantages of using a partnership.

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(i) Legal Status

A cardinal principle in partnerships is that the law imposes on each partner a duty to act at all times towards the other partners in a loyal manner and in good faith. This principle is referred to as a “fiduciary duty”. The effect of a partner’s fiduciary duty is that the partner is not allowed to take advantage of business opportunities or information obtained while a partner for his/her own personal use without the prior permission of the other partners. In addition, a partner cannot carry on a separate business in competition with the partnership without the consent of the other partners.

Partners carrying on business can sue or be sued in the firm name. In addition, a person cannot be both a partner and an employee of the partnership. Each partner is an agent of the partnership and of the other partners when acting in the normal course of business of the partnership or in what reasonably appears to be so. Therefore, one partner’s action will bind all of the partners. As a result, each partner is personally liable to liabilities, debts, and obligations as a result of the actions of the other partners, regardless of the proportionate capital contribution of the individual parties. Anyone obtaining judgment against the partnership can collect from any of the partners (usually the one with the most money). As such it is vital in choosing a partner that you trust and are familiar and comfortable with their business practices and ideas.

Property contributed by the partners to the business and property purchased by the partnership is called “partnership property” and is owned by the partnership.

The *Partnership Act* contains provisions that govern the relationship of the partners to each other. These provisions can be varied by agreement of all the partners which may be in writing or inferred from a course of dealing. Although most new partners believe that they were meant for each other and they’ll always

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get along, situations will almost always arise that the partners have not contemplated. If there is not a method in place for dealing with the situation and it cannot be resolved then the partnership will be in jeopardy. Therefore, it is strongly recommended that partners enter into a written agreement among themselves (called a “partnership agreement”) which outlines the duties and responsibilities of the partners, methods of making decisions, and dissolution of the partnership. The result is a greater trust among partners.

(ii) Partnership Registration

Persons carrying on business as a partnership must register the partnership name under the *Business Names Act* (unless the partnership is a limited partnership in which case it must be registered under the *Limited Partnerships Act*). The registration lists the name and address of each partner, the partnership name, the first date of use of the partnership.

However, it is important to note that you may be deemed to be in partnership with someone else even though you have not formally registered the partnership and as such you would be personally liable for the actions of the other “partner”.

(iii) Dissolution of the Partnership

Unless there is a written agreement (a “partnership agreement”) outlining the circumstances whereby the partnership will come to an end, a partnership will automatically terminate:

1. on the expiration of the term fixed for its existence;
2. at the completion/termination of the single adventure or undertaking for which it was created;

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3. upon any partner giving notice to the other partners of his/her intention to dissolve the partnership;
4. upon the death or insolvency of any partner; or
5. when ordered by a court to do so pursuant to certain circumstances under the *Partnership Act*.

3. CORPORATION

Many people prefer to carry on business as a corporation. A corporation is a legal entity separate in law from its owners.

The corporation is owned by “shareholders” through their ownership of “shares” of the corporation. A corporation can have different types of shares, the most common being “common shares” and “preference shares”. As the name implies, preference shares gives the holder certain rights or privileges that the common shareholders do not enjoy. For example, the preference shareholders may be entitled to receive profits from the corporation before any money is distributed to the common shareholders. However, in order for the preference shares to enjoy this preference, the preference shares may be structured such that preference shareholders are not entitled to any voice in the decisions of the business. The combination of rights and privileges that can be attached to the share types is unlimited.

When a corporation is created, the shareholders do not own the business or the property belonging to the corporation. The business and the property is owned by the corporation and the corporation in turn is owned by the shareholders. In addition, the rights and liabilities of the corporation are not also the rights and liabilities of the shareholders.

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A corporation is managed by people who are called the “directors”. The day-to-day operations of the corporation are carried out by people called the “officers” which can include a “president”, “secretary”, or “treasurer”. It is possible, and very common in small corporations that the same person can be a shareholder, director, and officer at the same time.

Similar to a partnership agreement, the shareholders can enter into a “shareholders’ agreement” among themselves outlining how the corporation is to be operated.

Profits of the corporation are distributed to the shareholders by way of “dividends” being paid to the shareholders. Generally, the amount of the dividend paid to a particular shareholder depends on the number of shares held by the shareholder.

(i) Advantages of a Corporation

1. Limited liability of shareholders. People are more willing to invest money in a corporation when they know that they don’t have to worry about being personally liable for the debts of the corporation. This concept is called “limited liability” for the shareholders. The shareholders’ liability is limited to the value of the assets (or money) that they have transferred (or paid) to the corporation in exchange for shares in the corporation. The amount that the shareholders paid for their shares is all that they will lose. (However, directors and officers can be liable in certain circumstances.)
2. Separate taxation of the corporation from its owners. Possible lower taxation rate.

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3. Estate and tax planning vehicles can be used to permit an “estate freeze”. The use of a “discretionary family trust” can permit income splitting among different family members. The shares of the corporation can be set up such that one share type have voting control of the corporation (usually held by you and your spouse) and another share type obtains all increases in the value of the corporation (usually held by your children).
4. The corporation can sue and be sued in the corporation name.
5. More prestige with the public in doing business using a corporation.
6. Perpetual existence of the corporation. The corporation can continue after the death of a shareholder or withdrawal of the shareholder by the sale of his/her shares.

(ii) Disadvantages of a Corporation

1. Higher initial startup formalities and cost. A corporation requires articles of incorporation be filed, a head office designated, notice naming director(s) and officer(s), a record book (called a “minute book”) must be maintained which contains among other information details of meetings of shareholders and directors.
2. Requires annual maintenance by accountant and lawyer. A corporate tax return must be filed and the “minute book” must be updated.
3. Losses incurred during the startup years cannot be used to offset income of the owner from other sources of income.

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Consultation with the *Law Office of Peter Cusimano*

I will help you through the maze of going about setting up and maintaining your business. When I meet with you I will examine your goals, your current financial situation, the nature of your business, expected sources of financing, number of people involved and the relationship of the parties. In addition, I will consult with your accountant to consider the income tax implications in choosing the most appropriate form of business for your business.

I will prepare and file all paperwork necessary to help you begin your business. By letting me do the legal work, you can have peace of mind and concentrate on your business.

Helping Your Business Prosper

After you have started your business, I can also help you in many other areas to protect your hard earned dollars and invested time. I can prepare your contracts to help protect you collect from non-paying customers and reduce disputes with customers. I will also review any contracts that you enter into including reviewing your lease, banking documents, and supplier contracts. I will ensure that before you sign any documents they are written in your favour so that if your suppliers do not deliver on time or deliver defective products to you, you will be protected. If you are planning to hire employees, I can prepare employment contracts for you that are designed to protect you from your employees stealing your valuable ideas and confidential customer information and using it to set up their own competing business or providing it to your competition.

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I am a business lawyer in Toronto, Ontario, Canada. If you are located in the Greater Toronto Area, I would be pleased to meet with you and represent you as your professional legal advisor.

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