



Business Law Playbooks

Part 4 – Incorporating a For-Profit Corporation

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

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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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4 Incorporating a For-Profit Corporation

For the purposes of this Playbook, we will only be discussing the “for-profit” version of a corporation, but the vehicle is available for other business models. Other forms of corporations will have their own unique challenges. For other forms of corporations, please refer to the corresponding Playbook for non-profit or charitable corporations.

4.1. Features of a Corporation

Corporations have six key features that distinguish the business vehicle from all others. These are:

1. Separate Legal Personality
2. Perpetual Existence
3. Limited Liability for Shareholders
4. Transferability of Shares
5. Ability to Centralize Management
6. Shareholder Control over Management.

Each of these features comes with its own implications.

4.1.1. Separate Legal Personality

One of the most important notions of incorporation is that corporations have all the legal rights of a natural person. This means that corporations are free to enter into contracts using their own name, borrow money on their own credit, own property, and declare bankruptcy, along with suing and being sued in their own capacity.

4.1.2. Perpetual Existence

The longest-running businesses are generally corporations for a reason. As they are their own legal person, the existence of a corporation is not tied to any one person's natural life. Though the founders and shareholders of a corporation may pass away, the corporation itself remains able to conduct its own business affairs through its directors and officers. Corporations only cease to exist when they fail to comply with their governing legislation, or when the decision is made to dissolve the corporation.

4.1.3. Limited Liability

The most attractive feature of incorporation is the limitation of liability for shareholders. As the corporation is a legal entity in and of itself, the corporation bears the ultimate responsibility for any liabilities it incurs, whether voluntarily (through contracts) or involuntarily (through tortious conduct). If for any reason the corporation is unable to meet its obligations with the assets and equity it owns, the shareholders cannot be sued for any outstanding balances. That being said,

there are specific circumstances where the shareholders can be held liable for debts of the corporation; or example, when the corporation is being used as an engine for fraud.

4.1.4. *Transferability of Shares*

Unless otherwise stated by the corporation, the shares of a corporation are transferrable. This allows for the creation of both “private” and “public” corporations. Private corporations are those where the ability to transfer shares is restricted, while the shares of a public corporation can be purchased by anyone. The shares of public corporations are normally listed on stock exchanges, like the Toronto Stock Exchange or the New York Stock Exchange. While the availability and transferability of shares make corporations an attractive business vehicle, in addition to the legislation that governs the incorporation of a company, the issuance of shares is governed by securities legislation. Unless a corporation issues shares through an exemption, the company will become a Reporting Issuer and be required to file a prospectus which is a very onerous and expensive undertaking.

Due to the transferability of shares, corporations also gain a unique ability different from all other business vehicles. This is the ability to perform what is known as “equity financing”, which is the raising of money through the offering of new shares. The converse to this is “debt financing”, where money is borrowed and repaid over time with interest.

4.1.5. *Ability to Centralize Management*

Due to the ability to disperse shares over a vast number of owners in the case of public companies, the ability to centralize management is crucial. Hence, corporations are run by the board of directors. The board of directors manage the direction of the corporation and are ultimately responsible for the decisions of the corporation. These directors can appoint officers to manage the day-to-day operations of the corporation.

4.1.6. *Shareholder Control over Management*

While shareholders do not exert direct control over the corporation, they can exert their influence in multiple ways. Chief among these is that the election of directors is done by the shareholders. Additionally, shareholders are entitled to vote on certain fundamental matters, and if enough shareholders support a decision, the board of directors can be compelled to implement that decision.

4.2. The Incorporation Process

The incorporation process is highly formalized, and many factors must be considered. It is best for you to consult with a legal professional to ensure that you set up a corporation that meets your needs. The following steps are among some of the considerations when incorporating a business.

4.2.1. *Step 1: Choose a Jurisdiction*

The process of incorporation starts with deciding on where you would like to incorporate. In Canada, businesses have the option of incorporating federally, provincially, or territorially. Each



province and territory has its own governing legislation, while federally incorporated companies are governed by the *Canada Business Corporations Act* (“CBCA”). For the purposes of this Playbook, we will only be discussing incorporation under the CBCA and the *Ontario Business Corporations Act* (“OBCA”).

A business only incorporates once. However, if you decide to incorporate federally, you must also register provincially or territorially depending on where you plan to conduct your business. For example, if you are an Ontario-based business that decided to incorporate federally, you must also register your business with the province of Ontario. In general, incorporating provincially does not bar your corporation from conducting business in the rest of Canada.

Incorporating federally gives some advantages, like Canada-wide name protection, the perceived value of a “Canadian” corporation, and a cheaper incorporation fee. However, ongoing management fees for federal corporations, like the fee to file the corporation’s annual return, are slightly higher.

On the other hand, a provincial corporation has some advantages as well, including a reduced amount of annual reporting obligations and its corresponding costs, as well as a lower hurdle when it comes to securing a unique name in the province. Some disadvantages include a higher upfront cost for incorporation, no Canada-wide name protection, and the perception of being a less prestigious entity compared to a “Canadian” corporation.

4.2.2. Step 2: Choose a Name

A corporation may choose to use a numbered name (e.g. 123456 Canada Inc.), or may opt to use a worded name. If you opt for a worded name, a name search will also have to be conducted to ensure that the name is not already taken. Regardless of whether the name is a number or word, a legal suffix must be attached to the name, like “Inc.,” “Ltd.” or “Corp.” The legal suffix is required to place the world on notice that the organization is a corporation, and the shareholders are not personally liable for the actions of the corporation. All contracts that a corporation enters must be under its formal name. However, like sole proprietorships and partnerships, a corporation can carry on business in Ontario under a different name if it registers under the *Business Names Act* (“BNA”).

4.2.3. Step 3: Prepare and File Your Incorporation Documents

Regardless of your decision to incorporate federally or provincially, two documents need to be filed; (1) the Articles of Incorporation and (2) the Notice of Initial Registered Office and First Board of Directors.

The articles of incorporation dictate the core structure of your corporation. This document will contain the share classes and their attached rights (more on that later), the corporation’s head office, the minimum and maximum number of directors, the powers granted to the directors, as well as any restrictions on the kinds of business the corporation can conduct. The Notice of Initial Registered Office and First Board of Directors is required to indicate the location of the

corporation (i.e. where corporate documents will be delivered), and to indicate the first director(s) to serve on the board.

Once you have successfully filed for incorporation, either Corporations Canada or Service Ontario (depending whether you incorporated federally or provincially) will send you a certificate of incorporation along with some other important information regarding your new corporation.

4.2.4. Step 4: Post-Incorporation Steps

After incorporating, there are several post-incorporation steps for the corporation to take. The corporation must draft and maintain its minute book, as well as its by-laws. Unlike the articles of incorporation, by-laws of a corporation dictate how the corporation will manage its affairs internally. Both shareholders and directors must meet to pass organizational resolutions. Among other requirements, the directors need to have a meeting to ratify the incorporation documents and pass by-laws. The shareholders must also have a meeting to adopt the by-laws and appoint the Directors in addition to other essential steps. Lastly, shares must be issued and paid for, a fiscal year end date set, and directors appointed.

For those businesses which were operating as a sole proprietorship or partnership before deciding to incorporate, one additional step is needed. The contracts which you may have entered (with suppliers, customers or licensors) before incorporating should be “assigned” to the corporation, where your obligations are assumed by the corporation. Until the contracts are assigned to the corporation, the sole proprietor or partners remain personally liable.

4.3. Maintaining a Corporation

Similar to a natural person, corporations need to be maintained. Every year, a corporation must file their annual returns with their respective governing bodies and hold an annual shareholders’ meeting to conduct corporate governance activities (e.g. elect directors). Corporations must also hold regular directors’ meetings and audit the account books. Other ongoing obligations include keeping a corporate minute book up-to-date, which requires steps including keeping minutes of any directors’ meetings, a shareholder ledger, and a copy of the corporation’s by-laws.

4.4. The Board of Directors

The board of directors has a wide range of powers. Unlike sole proprietorships and partnerships, the board of directors chooses the direction that the corporation will take, and they can appoint officers to run the day-to-day operations of the corporation. Shareholders normally exert control over the corporation by electing directors. However, it is not uncommon for the owner(s) of a start-up to be the shareholder, director, and officer of the corporation.

While the corporation is a legal person, the corporation needs natural persons to act for it. Hence, the directors are ultimately responsible for the actions of the corporation. Only shareholders have the benefit of limited liability, not the directors. Directors may be personally liable for past wages and criminal actions like fraud. In specific circumstances, directors of a corporation can

even be held liable for the business decisions of the corporation if they unfairly disregard the concerns of a stakeholder.

Under most Canadian corporation statutes, corporations may indemnify and purchase insurance to protect directors and former directors against liabilities incurred by reason of them acting as directors, provided the director was acting consistently with their fiduciary duties and had reasonable grounds for believing their conduct was lawful. It is also common to put director indemnity provisions in a corporation's by-laws.

4.5. Shareholder Rights

Despite the popular belief, shareholders do not own a corporation, or any of its property. As a legal person, the corporation is "owned" by itself, and owns its own property. However, shareholders are granted a bundle of rights to the corporation. The primary rights that are given to the shareholders are the right to dividends, the right to vote, and the right to a portion of the corporation's property upon dissolution.

Dividends are the primary method in which a corporation returns its profits to its shareholders. Whether a shareholder receives dividends and when dividends are issued will depend on which class(es) of shares that a shareholder owns. Information about what classes of shares can be found in a corporation's articles of incorporation. The right to vote also gives a shareholder substantial control over the affairs of the corporation, being given a say in fundamental matters as well as the ability to elect the directors of a corporation.

The right to vote is also important to consider when deciding to become a shareholder. There are some fundamental changes to a corporation that require shareholder voting (e.g. electing new directors, amending the articles of incorporation, amending the share structure, etc.). The right to vote essentially gives the shareholder control when it comes to voting on matters that set the boundaries in which directors can manage within.

Lastly, if the corporation is wound up or dissolved, shareholders may be entitled to a share of the liquidated assets as a return of their invested capital. Whether you receive a share of liquidated assets will depend on whether you hold shares that entitle you to such a distribution of assets.

The right to dividends, to vote, and to the assets upon dissolution must be assigned to at least one class of shares, but all three need not be given to each class. This means you can create a class of non-voting shares in exchange for more dividends or even a share class with vastly increased voting power to enable the founders to retain control.

4.6. Corporations vs Sole Proprietorships and Partnerships

The decision on whether to operate as a sole proprietorship or a partnership versus a corporation will depend on your plans for the business. Some factors to consider include:

- Are you planning to run the business by yourself, with a small group of people, or would you like to allow many people to have a say in it? The more people you would like to have partaking in the operation of the business, the more attractive incorporation becomes.
- What are your capital needs? Will you need to attract investors? The more capital-intensive your business, the more you should consider incorporating.
- How important is limited liability? Are you in a position to personally cover the liabilities of the business? If not, you may value the benefit of limited liability more heavily and should incorporate.
- Are you planning to pass on or transfer your business? Businesses that rely on personal services (e.g. hairdressers) where the owner is an important part of the business are less suited to incorporation, while a technology start-up is more suited to incorporating.

4.7. Conclusion

The decision to incorporate will depend on your plans for your business. Incorporating comes with many benefits, like limiting liability and the ability to raise vast amounts of capital, as well as being handed down or otherwise sold. These advantages are not free, and in exchange for these benefits there are many more maintenance costs and other compliance measures. Whether the benefits of incorporating outweigh the costs will depend on your personal situation. If you believe you are ready to incorporate, you may wish to contact the QBLC for assistance with the incorporation process.