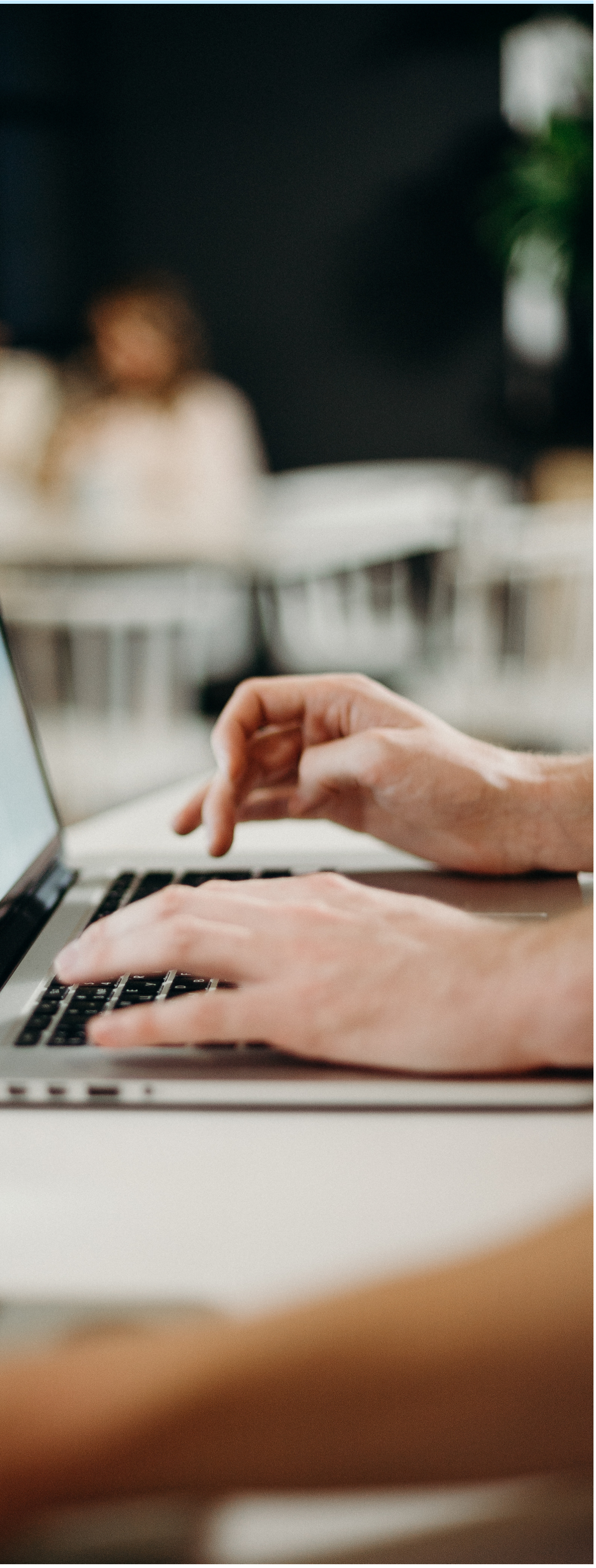
THE BUSINESS GUIDE

PREPARED AND PRESENTED BY

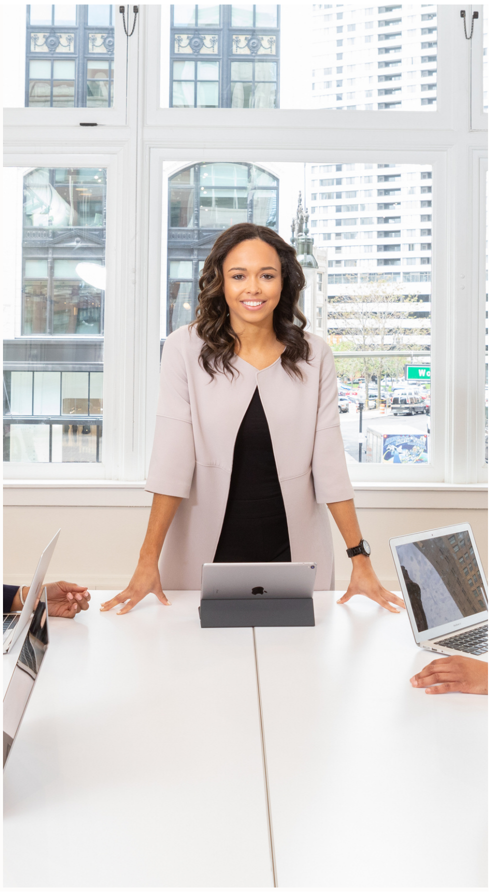
AION LAW PARTNERS LLP



IN THIS GUIDE

DECIDING ON A BUSINESS STRUCTURE THAT'S RIGHT FOR YOU

If you're thinking of starting a business, congratulations! It's a big step. Setting it up properly can make things easier and save you money down the road and that's where we come in. We can help you structure your business according to your unique needs and goals.



INTRODUCTION

To get you started, the business guide will introduce you to three kinds of business structures:

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- Sole proprietorships, which are run by just one person
- Partnerships, which are run by two or more partners who combine resources
- Corporations, which are separate legal persons entitled to conduct business in their own name

THESE STRUCTURES WILL BE DESCRIBED IN MORE DETAIL ON THE FOLLOWING PAGES. AS YOU WILL SEE, EACH HAS ITS OWN SET OF ADVANTAGES AND DISADVANTAGES; THERE'S NO "ONE SIZE FITS ALL" WHEN IT COMES TO RUNNING A BUSINESS.

Here are a few other things to keep in mind as you read:

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- Whenever you start a business, there's some potential for liability. Your business could harm someone or it could fail to pay its debts and you may end up personally responsible depending on the structure you choose
- Each business structure has tax benefits and consequences. We mention a few of them here, but it's always best to speak to a tax professional for more information

SOME STRUCTURES ARE MORE FLEXIBLE THAN OTHERS, ALLOWING YOU TO ADD BUSINESS PARTNERS, TRANSFER THE BUSINESS OR RAISE OPERATING FUNDS MORE EASILY.

SOLE PROPRIETORSHIPS

What Is a Sole Proprietorship?

A sole proprietorship is an unincorporated business run by just one person. There is no legal separation between the business and its owner, which means for tax and liability purposes, the person running the business is the business.

Sole proprietorships are often a good fit for small business owners whose business is unlikely to harm anyone or incur significant debt. Examples include retailers, freelance writers, graphic designers, and photographers, among others. And while they run the business alone, a sole proprietor can also hire employees, either for extra help or to expand.

Tax Treatment

A sole proprietor's business income is treated as personal income, and they pay tax on it at their individual income tax rate. If the business loses money, the sole proprietor can deduct those losses against personal income from other sources.

Advantages and Disadvantages

✓ A sole proprietor has full control over their business. They don't answer to shareholders or partners and are free to put the business on hold at any time

✓ Starting a sole proprietorship is often inexpensive with minimal paperwork is involved

✓ Sole-proprietorships are easy to end or "wrap up"; all the owner needs to do is stop running the business. However, if the business has any debts, they will still need to be paid off

✓ Sole-proprietors with low individual income tax rates are taxed favourably on business income. And being able to deduct business losses against personal income makes starting a business less risky than it might be otherwise

X A sole proprietor is personally liable for business debts. If their business harms someone, or fails to repay a loan, their personal assets may be put at risk

X Without contributions from shareholders or partners, a sole proprietor often must rely on personal savings and loans to raise startup funds

X Sole-proprietors with high individual income tax rates can be taxed heavily on business income. Someone with a high-income tax rate might be better off incorporating, but you'll want to speak to an accountant to be sure

Getting Started

Creating a sole proprietorship is fairly simple, but you still need to do a few things before you can start running your business. You may need a licence or permit, depending on the kind of business you want to open (a food service business, for example, would likely require a health and safety permit). You may also need to register your business's name with the Ontario government, unless you intend to operate using only your full legal name.

If you're confused on where to start, don't worry because we're here to help. Come talk to us and we can help guide you through these and other requirements you may need to know about to help you make the best decision for your business.

PARTNERSHIPS

What Is a Partnership?

If you're planning to start a business with one or more people, consider starting a partnership. Like a sole proprietorship, there is no separation between the business and its owners. A partnership is a vehicle where two or more partners can combine resources, share responsibilities and share profits, however, they see fit.

Partnerships are not limited to "natural" persons—corporations can be partners as well. A partnership may end if the partners agree to end it or if a partner passes away or wants to leave. A partnership agreement lets you customize when your partnership ends. You may decide, for example, that if a partner wants to leave, they can be bought out and the partnership may continue.

Tax Treatment

When a partnership begins, the partners decide how business income will be divided. Each partner is taxed on their share of that income at their individual income tax rate. If the partnership loses money, a partner can claim their share of its losses against their personal income from other sources.

Partnership Varieties

There are three kinds of partnerships—general, limited and limited liability. The main difference between them is the amount of liability protection they offer to partners.

General Partnership

In a general partnership, all partners have a say in how the business runs and all partners are personally liable for the partnership's debts. If the business fails to uphold a contract or repay a loan, creditors can go after any partner's personal assets.

This structure is generally well suited to low-risk businesses, because of the high liability risk involved. For example, it is unlikely anyone will be injured in a freelance writing business; each partner can be fairly confident that the other partners won't injure others or incur significant debt in the course of business. The same can't be said for a construction business, where injuries are more common and loans may be required to finance projects.

Limited Partnership

A limited partnership has two kinds of partners—general and limited. General partners run the business and are personally liable for all partnership debts, just like partners in a general partnership.

Limited partners, on the other hand, are liable only for their own actions, and not for anything the other partners do. Their personal assets are never put at risk and all they stand to lose is their initial financial contribution to the business, as well as any subsequent contributions they make. They have no say in how the business is run.General partners often receive a larger share of profits to offset the increased personal liability they take on. In return, they have full control over how the business operates.

Limited Liability Partnership

This structure is only available to certain "high risk" professions, including lawyers, doctors, dentists and accountants. In a limited liability partnership (LLP), there are only limited partners. Each partner is liable for their actions only and only to the extent of their financial contribution to the business. Their personal assets are never put at risk.

The partners must register with the government, before they can start running their business and must maintain the minimum liability insurance governed by the profession.

Advantages and Disadvantages

✓ Generally, partners with low individual tax rates are taxed favourably on partnership income

✓ Partners can deduct partnership losses against their personal income from other sources, including employment income

✓ A limited partnership is an effective way to raise startup funds. Limited partners will contribute money to the business, but won't be part of running the business itself, which is beneficial to general partners who want full control of the business

X Partners with high individual tax rates are often taxed significantly on partnership income. As a result, those with high tax rates may be better off incorporating

X Partners may be personally liable for partnership debts, which can put their personal assets (including their home) at risk

X Partners might not always agree on how to run the business, which can ead to conflict.

Getting Started

Once you decide who your partner(s) will be and what each of you will contribute, you are now ready to create a partnership agreement. A partnership agreement is a contract between you and your partner(s) that decides how the business will be run. It includes:

- Each partner's responsibilities
- Who owns what percentage of the business and how profits and losses will be shared
- When and how the partnership may end, including what happens if a partner dies
- How the partners will resolve disputes between them (for example, by mediation or arbitration)

Without a partnership agreement, your business may end when you don't want it to and disputes between partners may become so costly and time-consuming that it no longer makes sense to continue operating. We can help you create this agreement and keep your partnership running smoothly. Come talk to us!

CORPORATIONS

What Is a Corporation?

A corporation is a separate legal person that can operate a business in its own name. "Separate" means it is distinct from its owners, and like a "natural" person, it can hold property, trade goods, file lawsuits and employ others. For legal and tax purposes, it is its own entity.

Members of certain professions, if they choose to incorporate, must use a professional corporation. These are regulated not only by the Business Corporations Act (Ontario), but also by the specific statutes that govern each profession. Lawyers, doctors, accountants, and dentists, among others, use professional corporations.

Before you incorporate, come talk to us about whether your profession regulates how you can run your corporation.

Shares and Shareholders

Shareholders of a corporation define who owns the corporation and how much of it. When a corporation is created, different classes of shares with different powers and restrictions are authorized to be issued. These shares are issued to the owners, who are referred to as shareholders. For example, if person A owns 20 shares, person B owns 20 shares, and no other shares are issued, then both person A and person B have equal ownership of the corporation, being 50% each.

If a corporation has more than one shareholder, a shareholder agreement is highly recommended. A shareholder agreement defines all aspects of the relationship between shareholders, helping to eliminate disputes and providing protection to the shareholders. You can see the Michael and Associates Corporate Guide for more information on shareholder agreements or can give us a call!

Directors and Officers

Where shareholders of a corporation are the owners, the role of directors and officers is much like employees of the corporation. Shareholders appoint the director(s) of the Corporation to represent the shareholders; the director(s) must act in the best interests of the shareholders, ensuring that the business operates in a way that protects and/or increases share values.

Directors can elect officers and delegate their responsibilities to those officers—for example, a president, secretary or treasurer. These officers run the company on behalf of the directors and can make operating decisions within the scope of the power and authority granted to them by the Corporation.

It is possible, and common, for one person to hold all the positions above. For example, you might own shares in a corporation while also acting as director and president; in this example, you have full control over all aspects of the business. However, you will still be required to take on all roles and responsibilities that come with each title you hold, despite being just one person.

Tax Treatment

Where sole proprietors and partnerships are taxed on the individual's income tax returns, corporations are required to file income tax separate from the individuals who own and run it. The income generated within the corporation is taxed at the applicable corporate income tax rate, which can be more favourable than your individual income tax rate depending on the circumstances of your business. For example, in Ontario, if your corporation meets the qualifications of a "small business" you are entitled to the Ontario small business deduction on your corporation's income tax, which significantly lowers the tax rate.

The question you may be asking is, if the money is tied up in the corporation, how do those who own and run the corporation get that money into their own pockets? There are many different ways for corporations to pay shareholders and directors to reduce the tax payable (i.e. dividends, share conversions and redemptions, management bonuses, etc.) which can in effect save you more money than you would if it were taxed at your personal income tax rate.

There are many aspects to corporate tax planning that are outside the scope of knowledge of an everyday business owner. It is recommended that you have a good team of lawyers and corporate tax accountants who can ensure that you have a complete understanding of your options and that everything is properly documented and in compliance with the law. Our office works with a variety of tax professionals that have experience with businesses of all sizes and it would be our pleasure to connect you with those professionals that can provide you with the comfort to organize and run your business in a way that works best for you.

Liability

A big upside to incorporating a business is the ability to defer liability from the individual to the corporation. As previously discussed, a corporation is a separate legal entity from the individuals who own and run it and as such, the corporation bears all the liability that comes with the business it runs. Owning and operating a corporation provides you with assurance that liability, which arises out of the course of business remains with the corporation and your personal assets are protected. For this reason, corporations are often a popular choice for businesses that are at high-risk to incur liability such as construction companies, landscapers, accountants, doctors, and many others.

It is important to note that the individual may not always be protected from the liabilities of the corporation if they are acting fraudulently within their role and/or outside of the nature of the business. You can protect your corporation in this way by ensuring that the roles of shareholders, directors and officers are properly documented.

Advantages and Disadvantages

✓ Generally, corporations receive favourable tax treatment, with tax rates that are often lower than individual rates. This can make it cheaper for them to run a business.

✓ As of 2018, the federal corporate tax rate is 15% (after reductions), and for qualifying small businesses, that rate is even lower at 10%. There are provincial corporate taxes as well, but these are relatively small: 3.5% for qualifying small businesses, and 11.5% for all other corporations

✓ A corporation's owners have no personal liability (except in rare, extreme cases.) If something goes wrong, the corporation itself is responsible; its owners' personal assets are not put at risk

✓ It is relatively simple to transfer a corporation to family members or others and have them take over the business. A corporation also lives on after your death, allowing your business to carry on (which may not be the case for a partnership or sole proprietorship)

X Running a corporation is more expensive and complex than other business structures. There are incorporation fees and costs to maintain corporate records, which include corporate minute books, tax returns and financial statements. As well, failing to keep up with these requirements can result in audits and fines

X If a corporation loses money, its owners can't use that loss to offset their personal income from other sources for tax purposes

GETTING STARTED

Starting a corporation is often more complicated than starting a partnership or sole proprietorship, and we can help guide you through the process. See our corporate guide to get the ball rolling.

We can help you decide on the business structure that is best for you.

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