You can do your own incorporation!

The incorporation procedure in Alberta is easier than ever. You can incorporate a company yourself with very little trouble and no legal fees to pay. More and more people are using a corporate structure for their businesses.

This guide explains in easy-to-follow steps how to incorporate a small “non-distributing” company under the Business Corporations Act. Samples of the forms you need to incorporate and to keep your corporation in good standing are provided for easy reference.

Useful discussions on legal and business problems are aimed at getting your corporation off to a good start. A chapter on dissolving your corporation is included so you can bring your corporation to a graceful conclusion, should it become necessary.

Some of the most commonly asked questions answered in this book are —
- What are the benefits of incorporating?
- How do you choose a corporate name?
- How do you transfer assets into a corporation?
- What are the Articles of Incorporation?
- What are the fees for incorporating?
- How do you issue shares?
- What meetings must the corporation hold?
- Who can be a director or officer of the corporation?
- What annual reports must be filed?

Even if you decide not to incorporate, this book will serve as a useful guide to the workings of the Alberta Business Corporations Act.

About the author
Tom Carter, LLB, operated a private law practice for nearly 20 years. In 1998, he closed the practice to take a position as a senior trust officer and estate consultant with Canada Trust, and is now teaching law at Grant MacEwan College in Edmonton. Carter has been an instructor for the Alberta Bar admission course and has published several articles. He is the author of Your Health-Care Directive, So You’ve Been Appointed Executor, and Write Your Legal Will in 3 Easy Steps, all available from Self-Counsel Press.

Incorporation and Business Guide for Alberta

Tom Carter, Lawyer
- How to form your own corporation
- Includes tax advantages to incorporating

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3.1b Priority over names
3.1c Cost
3.2 Two types of Alberta corporations
  3.2a Distributing corporations
  3.2b Non-distributing corporations
3.3 Five different roles you must play
  3.3a Shareholder
  3.3b Director
  3.3c Officer
  3.3d Employee
  3.3e Creditor
3.4 The importance of shares
  3.4a Two classes of shares
  3.4b Par-value and no-par-value shares
3.5 Pre-incorporation contracts
4. Conclusion

2 HOW TO INCORPORATE
1. Alberta Corporate Registry and the Private Registry System
2. Choosing a Name for the Corporation
  2.1 Using a number for a name
  2.2 Choosing a name
    2.2a The distinctive element
    2.2b The descriptive element
    2.2c The legal element
  2.3 Searching and reserving the name
3. Four Incorporation Documents
  3.1 NUANS Report
  3.2 Articles of Incorporation
  3.3 Notice of Address or Notice of Change of Address
  3.4 Notice of Directors or Notice of Change of Directors
4. Congratulations! It's a Corporation!

3 AFTER YOU INCORPORATE
1. Organizational Meetings and Minute Books
  1.1 Organizational meeting of first directors
    1.1a Adopt By-law 1
    1.1b Adopt share certificate
    1.1c Adopt corporate seal
1.1d Appoint officers 45
1.1e Issue shares to shareholders 45
1.1f Authorize banking 45
1.1g Dispense with appointment of auditor 45
1.1h Waiver of notice of the meeting 47
1.2 First meeting of shareholders 47
   1.2a Elect directors 47
   1.2b Confirm By-law 1 47
   1.2c Confirm decision not to appoint auditor 47
1.3 Setting up the minute book 47
2. Moving Personal Assets into the Corporation 54
   2.1 By shareholder’s loan 54
      2.1a Promissory note 54
      2.1b General security agreement 54
   2.2 By rollover 54
3. Borrowing Money from a Bank 54
4. Doing the Books 57
5. Government Licenses and Regulations 57
   5.1 Federal government 57
      5.1a Goods and Services Tax 57
      5.1b Canada Pension Plan and Employment Insurance 57
   5.2 Provincial government 57
      5.2a Alberta Corporate Income Tax 57
      5.2b Workers’ Compensation Board 57
      5.2c Provincial licenses 58
   5.3 Municipal regulations 58
      5.3a Business licenses 58
      5.3b Municipal taxes 58
6. Keeping Your Corporation Alive 58
   6.1 Annual general meeting 58
   6.2 Annual return 58
7. Conclusion 61

4 LOOKING AHEAD: BUY-SELL AGREEMENTS, UNANIMOUS SHAREHOLDER AGREEMENTS, SHAREHOLDERS’ REMEDIES, AND ENDING THE CORPORATION 64
1. Buy-Sell Agreements 64
   1.1 How does the agreement work? 65
   1.2 When will the agreement kick in? 65
1.3 What price will be paid for the shares? 65
1.4 Where will the money come from? 66
1.5 Always get good advice 66
2. Unanimous Shareholder Agreements 66
3. Shareholders’ Remedies 75
4. Ending the Corporation 80
4.1 Failure to file annual returns 80
4.2 Voluntary dissolution 80
4.3 Involuntary dissolution 80

SAMPLES
1 Declaration of Trade Name 3
2 Declaration of Partnership 6
3 NUANS™ Report 20
4 Articles of Incorporation 22
5 Notice of Address or Notice of Change of Address 24
6 Notice of Directors or Notice of Change of Directors 25
7 Certificate of Incorporation 27
8 Minutes of Organizational Meeting of First Directors 29
9 By-Law No. 1 30
10 Sample Share Certificate 46
11 Minutes of First Meeting of Shareholders 48
12 Register of Directors 49
13 Register of Shareholders (Members) 50
14 Completed Share Certificate 51
15 Particulars of Share Transfers 53
16 Register of Mortgages 55
17 Promissory Note 56
18 Minutes of Annual General Meeting of Shareholders 59
19 Minutes of Annual Meeting of Directors 60
20 Annual Return 62
21 Letter Confirming Filing of Annual Return 63
22 Buy-Sell Agreement 67
23 Shareholders’ Agreement 76
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When I was practising law, I was surprised at the number of people who wanted to run their own businesses but assumed they couldn’t do that unless they incorporated a company. They didn’t understand that there are several legitimate ways to carry on a business. While incorporation is the right choice for many, it is not the right choice for all.

Before you plunge into incorporation, I want you to be sure it is the right choice for you. That’s why I begin this book with a discussion of the three different ways of carrying on a private business.

1. Do You Really Need to Incorporate?

There are three ways to carry on business, and it is important for you to know the advantages and disadvantages of each. Once you understand each way, you will be equipped to decide if it’s really necessary for you to incorporate.

1.1 Sole proprietorship

A sole proprietorship is an unincorporated business that you own and operate by yourself. But even though sole proprietorships are simply one-person operations, there are thousands of them, and they carry on an incredible variety of business activities. Most home-based businesses are unincorporated sole proprietorships, and almost every incorporated business started out as the unincorporated gleam in its founder’s eye.

There are many advantages to sole proprietorship. One of the biggest of these is control. For example, as a professional writer, I am sole proprietor of my unincorporated writing business. I do all the work myself — make contacts with editors and publishers, discuss ideas for projects, negotiate the contracts, do the research, write the material, send it in, send in my bill — all in my own name. Like other writers, I am free to hire someone to help me if I wish. If I needed to do so, I could hire a researcher to dig up information for me or a typist to re-do a manuscript, but that doesn’t change the fact that I own and operate my business.

All the income I earn from my business is mine. I don’t have a separate bank account for my business earnings, because I don’t need one, but I do keep track of what I earn from my business as I must report that income on my tax return every year. However, like any sole proprietor, I am free to deduct from that income any and all legitimate expenses of carrying on my business. This is an important point that many people misunderstand. You don’t have to incorporate to deduct business expenses.

Many people also think they must incorporate to protect the name they use to carry on business, but this is not so. Anyone operating a sole proprietorship can take steps to ensure that their business name is protected. For example, let’s say that Sally Smith has her own, sole-proprietorship business making custom-designed tablecloths. She calls her business Sally’s Table Trappings. This is
called a trade name, and it is perfectly legal for Sally to use it, provided it is not already in use by someone else. If Sally wants to be sure that no one else is using this name, she can order a search of all similar trade names currently registered with Alberta Corporate Registry by going to any private registry office.

As her business grows and her trade name becomes known, Sally might worry that someone might take advantage of it, either by using it outright or by using a close variation of it that might confuse her customers. If she hasn’t done so already, she can protect herself by registering her trade name at Corporate Registry by filing a Declaration of Trade Name. (See Sample 1.) She can do this through any private registry office. Sally would simply fill out the form, take it to any one of the private registry services in Alberta, and pay the necessary fees. Alberta Corporate Registry charges $10 to register a Declaration of Trade Name, and each private registry office charges its own fee on top of that.

(Incidentally, this example illustrates another of the advantages of operating as a sole proprietor: Aside from the Declaration of Trade Name, which is optional but highly recommended, there are no papers to file with the Alberta government. You can just get started.)

Of course, there are disadvantages to sole proprietorships. One of these is that the law does not perceive the sole proprietor and his or her business as separate entities; the proprietor and his or her business are considered one and the same. That means that Sally is personally responsible for the costs she incurs while operating her business. If she bought some supplies for her business, such as expensive cloth or a new sewing machine, and hadn’t made enough money that month to pay for them, she would have to dip into her private funds to cover the bill. If she didn’t pay, she would be sued personally, and if she lost, she would have to pay the judgement out of her own pocket. In other words, she personally faces unlimited liability for the debts of her business.

However, if Sally incorporates her business, her corporation would be the buyer of these items. If her corporation couldn’t pay, it would be sued, not Sally herself. Any court judgement could be satisfied only out of the corporation’s funds, and Sally’s own money would not be at risk, owing to a combination of two features of incorporated companies: separate legal entity and limited liability. (For a further discussion of these characteristics, see sections 1.3a and 1.3c.)

One other disadvantage of sole proprietorship is that when the sole proprietor dies, the proprietorship dies. In the case of Sally’s Table Trappings, any equipment and assets that Sally had used to run the business would pass under her will to the beneficiaries of her estate to be disposed of as they wish. (This is one way in which a sole proprietorship differs from an incorporated business, which does not die with its owner. An incorporated business continues to exist, a feature called perpetual existence, and ownership of the company can be easily transferred, as we shall see in section 2.2.)

Of course, as a sole proprietor, Sally is free to try to sell her business at any time before she dies, if she can find an interested buyer who isn’t afraid that her customers will go elsewhere. Customers often feel a close bond with the sole proprietor, and they may not be willing to continue to do business with a new owner whom they don’t know and with whom they have never dealt, especially if there are many other businesses offering the same products or services.

## 1.2 Partnerships

The second common way of carrying on business without incorporating is by forming a partnership. Unlike sole proprietorships, which are not covered by any specific piece of legislation, partnerships in Alberta
SAMPLE 1
DECLARATION OF TRADE NAME

Declaration of Trade Name
Partnership Act

I, 
Name of Declarant

of 
Resident Address in Full

declare that:

1. I have been carrying on or intend to carry on the business of

   manufacture and sale of table linens.

   Type of Business

   In EDMONTON, in the Province of Alberta, under

   City, Town, Village

   the name of SALLY'S TABLE TRAPPINGS

   Trade / Business Name

   Use of this name commenced on 1 JAN 20--

   Day / Month / Year

2. No other person or persons are associated in partnership with me in this business.

   SALLY SMITH

   Name of Declarant (please print)

   1 JAN 20--

   Date of Declaration

   BUSINESS PERSON

   Occupation

   DRIVER'S LICENSE #1

   Identification

This information is being collected for the purposes of corporate registry records in accordance with the Partnership Act. Questions about the collection of this information can be directed to the Freedom of Information and Protection of Privacy Coordinator for the Alberta Government, Box 3140, Edmonton, Alberta T5J 2G7, (780) 427-7013.
are governed by the *Partnership Act*, which gives us definitions of three important terms:

- **Partnership:** The relationship that subsists between persons carrying on a business in common with a view to profit. [As you would expect, this definition confirms that a partnership involves more than one person, but it doesn’t say how many a partnership may involve. In fact, you can have two partners, 22, or more.]

- **Business:** Business includes every trade, occupation, and profession, so partnerships can carry on almost any type of business you can imagine.

- **Firm** and **firm name:** Persons who have entered into a partnership with one another are collectively called a firm, and the name under which their business is conducted is called a firm name. A partnership can protect its firm name by filing a Declaration of Trade Name, if it wishes.

Partnerships are commonly used by lawyers, accountants, and other professionals, but they can also be used by people who do not wish to incur the cost and complexity of incorporating.

Let’s assume that Sally has talked about her idea for a custom table-decoration business with her friend and next-door neighbour, Mary, who thinks it is a great idea. Sally has the sewing and design experience, and Mary knows lots of people who entertain lavishly and would be willing to pay for unique, exotic tablecloths and napkins. The pair decide to start the business together. Because there are two of them, their business can’t be a sole proprietorship. And they don’t want to go through all the formalities and expense of incorporation, because they aren’t sure yet if the business will succeed.

In fact, Sally and Mary will be partners, and unless they decide to write their own partnership agreement, their business relationship will be governed by some basic rules found in the Alberta *Partnership Act*. The most important of these is that each partner is an agent of the firm and of the other partners. This means that each is personally liable for the actions of the others due to a legal principle called *joint and several liability*. For example, Sally might decide to order some expensive gold thread or a fancy sewing machine. Even if Mary knows nothing about this, the principle of joint and several liability means that Mary will still be personally responsible for payment of the bill.

Because of this principle, Sally and Mary had better be sure they trust one another, since each has the power to expose the other to significant liability. However, the news is not all bad. There is another principle that says *all the partners are entitled to share equally in the capital and profits of the business*. So if Sally and Mary make money, they share it equally, unless, of course, they have a written agreement stating otherwise. A partnership does not file its own tax return, but it does have to keep track of its income and expenses, and Sally and Mary must report their shares of any profits as income on their personal tax returns every year. Sally and Mary will prepare a financial statement for the partnership each year showing how they divided the profits.

While partnerships that deliver professional services do not have to file any documents at Corporate Registry, partnerships that engage in manufacturing, trading, contracting, or mining do. Specifically, such partnerships must file a Declaration of Partnership, which must be signed by all the partners. It must give the partners’ names, occupations, and residences; set out the name of their firm; state how long the firm has existed and will exist; and confirm that they are all the partners involved in it.

A sample of the Declaration of Partnership that Mary and Sally will file is included.
here. (See Sample 2.) The Corporate Registry fee for filing it is $10, and the private registries charge their own fee on top of that.

The Partnership Act sets out many other rules for partnerships. Some of these concern the retirement of partners and the addition of new partners. Since a partnership does not necessarily survive the death of a partner, there are also rules for winding it down if a partner dies. Again, if Sally and Mary do not want these rules to apply to their partnership, they would have to create their own partnership agreement that sets out the arrangements they prefer.

The Partnership Act also provides rules for a special kind of partnership called a limited liability partnership. As the name suggests, such partnerships exist to soften the impact of unlimited liability on partners. In a limited liability partnership, liability rests on the shoulders of a general partner. Liability of the other partners is limited to their stake in the partnership. Limited liability partnerships are never used by new businesses of the kind we are discussing, so details of these partnerships are not discussed in this book. For a further discussion of limited liability partnerships and also of partnership agreements, see Canadian Legal Guide for Small Business, available from Self-Counsel Press.

1.3 Corporation

The third way to carry on business is through an incorporated company, also called a limited liability corporation, or just simply a corporation. Corporations are distinct from sole proprietorships and partnerships because of three special legal principles that apply only to corporations, and not to sole proprietorships or partnerships. These principles are separate legal entity, perpetual existence, and limited liability. You must understand each of these before you can understand the advantages and disadvantages of incorporating.

1.3a Separate legal entity

When it comes to corporations, the law plays a game of “let’s pretend.” The law pretends that a properly constituted corporation is an independent personality, separate and distinct from its incorporators.

This bears repeating: A corporation is recognized by the law as something altogether different and apart from the human beings who create it. It is every bit as real as they are as far as the law is concerned. This is so even though a corporation can’t do anything by itself. It has to have human beings to make it work.

The concept of separate legal entity is one of the great leaps of the legal imagination; perhaps the greatest, if you consider that without it, the world of modern business, with its giant multinational corporations, could not exist.

1.3b Perpetual existence

A corollary of separate legal identity is that a corporation has the potential to exist forever. The people who set it up will die, but that has no effect on the corporation. It will continue to exist as long as it is kept up-to-date with Alberta Corporate Registry, or until it is closed down by those who control it.

1.3c Limited liability

The third principle relates to the need to give entrepreneurs protection from the costs of taking on new and potentially risky business ventures. As we have seen, sole proprietors and partners are fully liable for the costs they incur while doing business. If the business doesn’t have the money to pay, they are personally responsible for the entire amount. However, by creating the corporation — this new legal creature with separate identity and perpetual existence — those behind the corporation are sheltered by the law. Only the corporation is responsible for its business debts, and it can pay...
We, SALLY SMITH
Name of Declarant

MARY JONES
Name of Declarant

declare that:

1. We are carrying on or intend to carry on the business of
   manufacture and sale of table linens
   Type of Business
   in EDMONTON in the Province of Alberta, under the name
   City, Town, Village
   of SALLY & MARY'S TABLE TRAPPINGS
   Business Name

2. The said partnership has existed since 1 JUNE 20--
   and that the
   partnership will exist; (a) [ ] until
   Day / Month / Year
   (b) ☑ for an indefinite period.

3. The persons named in the declaration are the sole members of the partnership.

4. Date of declaration 2 JUNE 20--
   Day / Month / Year

5. Name, Address, Occupation and Identification of Partners (If more than two partners, please attach a list)
   Name: SALLY SMITH
   Resident
   Address: 12345 67 AVE. EDMONTON AB A1B 2C3
   City, Town, Village Province Postal Code
   Occupation: BUSINESS PERSON
   [DRIVER'S LICENSE #]
   Identification

   Name: MARY JONES
   Resident
   Address: 12347 67 AVE. EDMONTON AB A1B 2C3
   City, Town, Village Province Postal Code
   Occupation: BUSINESS PERSON
   [DRIVER'S LICENSE #]
   Identification

This information is being collected for the purposes of corporate registry records in accordance with the Partnership
Act. Questions about the collection of this information can be directed to the Freedom of Information and Protection
of Privacy Coordinator for the Alberta Government, Box 3140, Edmonton, Alberta T5J 2G7, (780) 427-7913.
those only out of its own assets. The people who stand behind the corporation are not personally responsible to pay its bills if it can’t.

This may sound like a recipe for fraud. All kinds of legitimate bills could be avoided if people set up corporations to do their business for them and put little or no money into those corporations. However, in the real world, very little business is done with corporations that aren’t seen as creditworthy. If the person doing business with a corporation has any doubts about its ability to pay, he or she will look for additional guarantees of payment. The most common of these is a personal guarantee from the owners of the corporation. This document, signed by the owners of the corporation, makes them fully liable for the costs incurred if the corporation is unable to pay. For more information on personal guarantees, see section 2.1b.

These three principles are at the foundation of any corporation, whether it be a one- or two-person business or a giant like General Motors. Together, they are the reason why the corporate form has become the preferred way of doing business in our economy. Now that we understand them, let’s take a look at the advantages of using a corporation for business, from the point of view of our two entrepreneurs, Sally and Mary, and look at some other factors they need to consider as they think about setting up their own corporation.

2. Seven Factors to Consider before Incorporating

2.1 The limits of limited liability

Limited liability is the main thing many people think about when they start a corporation. They take comfort in the idea that their personal assets will be protected from the corporation’s creditors. In reality, however, there are several limits on this protection.

2.1a Common-sense limits

People like Sally and Mary who start businesses are practical, careful people. They do not become successful in business by buying more supplies than they can afford or by producing more product than they can sell. Also, suppliers are not stupid. They didn’t get to be successful by selling lots of their product or granting huge amounts of credit to new businesses that can’t afford to pay them. So in the beginning, at least, limited liability — protection of their personal assets from claims by suppliers and creditors of their business — won’t be a big concern to Sally and Mary. If they buy only what they can afford and if they are prompt about paying their bills, limited liability will have little practical significance.

However, as their business grows, limited liability might become very important. As they gain new customers and hire more people, they will inevitably lose direct, personal control over what each and every employee is doing, and over the terms of each and every contract the company makes. Mary and Sally will move from being hands-on operators doing everything themselves to managers of others hired to do things for them. Therefore, limited liability will become more and more relevant.

2.1b A legal limit: The personal guarantee

As I’ve mentioned, suppliers are not stupid. They know about limited liability. They know that if they deal with small corporations on nothing more than the strength of a promise to pay the bills on time, they might end up with a pile of bad debts and nowhere to turn to collect the money. So, being prudent business people themselves, they look for other assurances of payment.

In the case of small corporations, the most common of these is a personal guarantee from the owners of the corporation — a
document that says that if the corporation can’t pay, the owners will, and that to back up that promise, the owner’s personal assets are available to cover the bill.

For example, let’s say that Sally decides to rent a space in a strip mall for the business. She isn’t worried about the cost because she knows that limited liability protects her from the company’s debts. She assumes the landlord will let the company sign the lease; as a result, she and Mary will not be obligated to cover the rent, even though she has no intention of seeing that happen. After all, she is in business to succeed, not to fail.

She finds a nice spot and calls the landlord to arrange a meeting. They discuss the business, and the landlord finds that he not only likes Sally but he can see that she is a very good, honest person. But that doesn’t change the fact that hers is a new company, and the landlord wonders whether or not the company is going to be able to earn enough money every month to pay the rent. To protect himself, the landlord asks Mary and Sally to sign a personal guarantee that obligates them to pay out of their own pockets if the company can’t.

Similarly, Mary and Sally may approach their bank for a loan for the company. Banks are not in the business of loaning money unless it can be repaid, and they are on the lookout for small corporations that don’t have enough assets to back up their loans. Once again, the bank will ask Sally and Mary to sign personal guarantees of any loan it gives them.

In this way, when dealing with banks and landlords, the advantage of limited liability is eliminated. Later, when the company has grown to sufficient size that the payment of rent or bank loans is no longer at risk, these personal guarantees are less likely to be needed.

Note that in Alberta, a personal guarantee must be in writing and a certificate of independent legal advice must be attached to it for it to be legal. This means that both Sally and Mary have to go to an independent lawyer to get it signed. They cannot use the bank’s lawyer, or the landlord’s lawyer, but they can use their own, if they have one.

2.1c Liability for negligence

Another limit to limited liability that is often misunderstood is liability for acts of personal negligence. Limited liability may protect you from responsibility for business debts that your corporation incurs, but it never protects you from responsibility for negligent acts that cause harm or injury to other people. In other words, if you harm someone, you can’t hide behind your company and say that you are not responsible for the damage you caused.

For example, let’s say the company buys a car that Mary uses to visit customers. If she runs a red light and hits someone, Mary can’t say that it is only the company’s responsibility. Mary herself is responsible as the driver of the car, and both Mary and the company will be sued. In reality, the company will have insurance to cover such a loss, but if it didn’t, Mary would have to cover it herself, and her personal assets would be available to do that.

The sphere of negligence is a huge area of law. A full discussion of it as it relates to corporations is beyond the scope of this book.

2.1d An example of limited liability at work

Here is an example of limited liability at work. An employee of Sally and Mary’s incorporated company enters into a series of unprofitable contracts or orders unnecessary supplies. If the employee made the deals as part of his or her normal job, the company is responsible and the company will get sued. If the company can’t pay the amount owing and is closed down, Sally
and Mary will lose only whatever money they put into the company; usually that is the amount they paid for their shares and the amount of any loans they may have made to the company to help it run. But they will not be sued personally, and their personal assets will be protected.

2.2 The advantage of perpetual existence

As we saw, if a sole proprietor or partner dies, the proprietorship or partnership is terminated. Whether or not the business continues will be up to the heirs of the proprietor or the surviving partners.

However, a corporation does not die when one or all of its owners do, nor does a corporation end when an owner decides to get out of the business. That’s because corporations have perpetual existence. Like the Energizer Bunny, they just go on, and on, and on. It’s business as usual. Any contracts the corporation has with customers and suppliers continue, and so do the debts and other obligations, such as paying the rent or the bank loan.

2.2a A practical example of perpetual existence

Let’s look at what that means for Sally and Mary. What would happen to their corporation if they went on a business trip to Mexico to check out cheaper facilities for making their products, and the plane went down? If they did not survive the crash, their ownership in the company (represented by their shares — I will discuss the specifics of this later) passes under their wills to their heirs. Sally’s shares go to her husband, who is a dentist. Mary’s shares go to her three children. The company continues, but it now has entirely new owners who may not know anything about the business, who may not have the time or desire to run it, and who may not even get along.

The good news is that they have something to sell: their shares in the successful business that Sally and Mary built up. If they sell their shares, the company carries on. Not only do the new owners benefit from all the hard work Sally and Mary did, they can carry on and continue to make it grow.

The bad news is that there may not be anyone willing to buy the shares. Even though the business is being run through a corporation, it may still be Mary and Sally’s business in the eyes of the most important people — the customers. With the two founders gone, the customers might decide to take their business to other people they know, rather than take a chance on new owners they don’t know. If that happens, the heirs have no choice but to wind up the company, sell its assets, and pay its debts. If the sale of the corporation’s assets doesn’t raise enough to cover the debts, at least the heirs are protected from having to pay the excess out of their own pockets, thanks to limited liability. However, they will still have to pay any debts covered by personal guarantees. Those documents will contain clauses that say they are binding on the heirs and administrators of Sally’s and Mary’s estates.

You don’t have to have a two-person corporation.

I use the example of two people forming a corporation, but under Alberta law there is no limit on the number of people who can incorporate a company. It is even possible for just one person to do so. In fact, every year, a large number of new, one-person corporations come into existence. If you wish to set up a one-person corporation, all you have to do is eliminate the references to the second person in the forms. Simply show yourself as the incorporator, the only director, the owner of all the shares, and the president.
2.3 Tax advantages

Aside from limited liability, possible tax advantages are the most common reason why people want to set up corporations for their business activities. That’s because of a tax benefit available to small corporations, called the small-business deduction, that the federal government introduced in 1971 to encourage the development and growth of small businesses. Alberta, which also taxes the income of small corporations, offers a parallel benefit.

The small-business deduction applies to the first $400,000 of active business income that each small, privately owned incorporated business earns each year. Active business income is income earned from the corporation’s normal activities, but does not include income from investments. The effect of the combined federal and Alberta deductions is that small-business corporations pay tax at a rate of 14 percent on the first $400,000 of active business income.

2.3a Will you pay less tax?

If your business earns less than $400,000 and your corporation can pay tax at a rate of only 14 percent, who wouldn’t incorporate? But remember who is paying the tax — your corporation; and remember where the leftover money is — in the corporation. The problem now is how you get it out and into your pocket, and what happens from a tax point of view when you do.

Once again, let’s take the example of Mary and Sally. They can take dollars out of their corporation by paying themselves a fair and reasonable salary for the work they do for the corporation, or by taking dividends on their shares, or a combination of both.

If they take a salary, that amount becomes a deduction the corporation can claim, but that amount is income in Sally’s and Mary’s hands. In fact, the corporation must issue a T4 slip to each of them, and they must declare that amount on their own personal tax return each year. Net result? No savings. If they take dividends, the same result applies. No tax savings. There used to be savings if money was taken out as dividends, but the government has been working hard to tighten up the rules over the past few years in order to eliminate that. So incorporation may not result in a tax saving to Mary and Sally.

2.3b Can you defer tax?

If your corporation is earning more money than you need to live on, and you can afford to leave after-tax income in the company, then you will see a savings, at least until you need to take that money out for yourself. This tax-planning strategy is called tax deferral. The money you leave in the company is taxed at the small-business rate, and the next level of tax (the tax you would pay on it personally if you took it out of the business) is deferred, or delayed, until that money is actually paid out to you as salary or dividends. This strategy is useful if your corporation’s income fluctuates from year to year and you want to even out the flow to yourself, and if you can afford to live without any money from the corporation from time to time.

Another deferral strategy available to corporations involves declaring a bonus, which works like this. Let’s say Sally and Mary’s corporation had a good year in 2000 and earned more than $400,000 in active business income. The company can declare a bonus payable to them in the amount of the excess over $400,000 as long as that amount is reasonable. Then the company can deduct that bonus from its earnings for the year 2000, which brings its active business income down to the 14 percent tax level. Of course, that bonus has to be paid to Sally and Mary, and in fact the company can then wait up to 180 days after the end of the year 2000 to pay them. As a result, the bonus is not taxable to them until 2001. By adopting this strategy, Sally and Mary have delayed...
paying tax on the bonus amount into the next tax year. Whether or not this is a benefit to them depends on their other sources of income for 2001, including any more money they take out of the corporation during that year.

2.3c Can you split tax?
Both of these tax-deferral strategies involve splitting income between two taxable entities — you and your corporation — to get the lowest rate. There are other tax-splitting devices you may be able to use with your corporation, and the most common of these is to split income between family members. If you have a spouse or children who are in lower tax brackets than you are, you can arrange to have your corporation pay dividends to them. Of course, if they are working for the corporation, the corporation can pay them fair and reasonable wages for the work they do.

2.3d Estate-planning opportunities
Corporations can be used to cap the value of a shareholder’s interest, which in turn caps the amount that has to be declared for tax purposes when that shareholder dies. The most common strategy for doing this is called an estate freeze, and it works like this.

Let’s say Sally and Mary’s business flourishes as an unincorporated company, and after only a few years they are offered a half-million dollars for it. They decline to sell, but decide for estate-planning purposes to incorporate their business. They transfer their business to this newly created corporation and take back a special class of shares, called preferred shares, which have a fixed value of $250,000 each.

They also set up the normal kind of shares, called common shares, the value of which will grow as the corporation grows. If Mary and Sally did not also own the common shares, then at their deaths, the value of their interest in the corporation would be frozen at the value of the preferred shares, which is $250,000.

There are many variations on this approach, and Mary and Sally would have to take a number of factors into consideration before doing this, all of which are outside the scope of this discussion. They should consult a lawyer or an accountant, or both.

2.3e Always get professional tax advice
Tax is a complicated technical area, and the information given above is meant to serve only as an introduction. You should always have your own specific situation reviewed by a competent tax advisor before making your decision about the tax advantages of setting up a corporation.

2.4 Complexity
It may be clear by now that setting up a corporation does make life more complex, mainly because that corporation is an independent legal personality that must be maintained and properly cared for. Sally and Mary will soon find that to incorporate, they must set up bank accounts for the company that are separate from their own, keep a separate set of books, and as we shall see, go through the necessary procedures to bring the corporation alive and keep it alive as far as the government is concerned.

They must also see to the preparation and filing of corporate tax returns: one for the federal government, and a separate one for the Alberta Government, because Alberta collects its own corporate income tax.

Sally and Mary must prepare the corporation’s annual financial statements, and they must keep track of all the legally required books and records (which I’ll discuss in Chapter 3).

Above all, they must always remember that they are not the corporation. The corporation is an independent legal entity, and
even though they are the instruments that make it function, it is different and distinct from themselves.

2.5 Cost

Sally and Mary must consider the fact that it costs money to start and maintain a corporation. Even if they avoid legal fees by incorporating themselves, they still have to pay the incorporation fees charged by the Alberta government and the fees charged by the private registry offices. They may also need an accountant to help them with bookkeeping and tax returns, and though they may set up the corporation without legal help, they will surely find that they need legal advice as the business develops and the corporation grows.

2.6 Handling growth

Overriding all these other concerns is the possibility that their business might become very successful. If so, Sally and Mary will need employees, premises, bank loans, and many other business services as well as advisors. They will quickly realize that they are unable to do it all on their own and will need to hire good people to help them, either as employees or as professional advisors. They may also need more people to put money into the business, and that raises the possibility of taking on more shareholders and directors. If the business gets big enough, Sally and Mary may even want to consider selling shares to the general public through a stock exchange. The corporate form of business provides the best way to handle all the challenges brought on by growth.

2.7 Credibility

One of the biggest reasons why people choose to set up a corporation to run their business is credibility. They want to look like serious businesspeople in the eyes of their suppliers and customers, and also in the eyes of lenders, such as the banks. The fact that the business is incorporated makes a positive impression. It says that Sally and Mary are serious about what they are doing, that they have put a significant amount of their own time and money into getting their business started in the most sophisticated way, and that they are confident of success. This will create a good, businesslike impression in the minds of any potential lenders.

3. Five More Things to Know before Incorporating

Mary and Sally have made the decision to incorporate, but there are five more things they need to think about before they start filling out their incorporation papers.

3.1 Federal or provincial incorporation?

Mary and Sally live in Alberta, and their corporation will carry on business in Alberta, so it’s obvious they will incorporate in Alberta, right? Of course, but they need to know that there are two incorporation systems available to businesspeople in this province. Both the federal and provincial governments have authority over the incorporation of companies under Canada’s constitution, so Sally and Mary can incorporate their Alberta business under the federal system or under the Alberta system. However, they must be aware of the three main differences between these two systems.

3.1a Where the corporation can carry on business

A business incorporated under the federal system is entitled to carry on business in any province or territory in Canada, while a provincially incorporated company can do business only in the province in which it is incorporated. However, this distinction gets watered down in practice, because every federally incorporated company must still file papers and register its existence in each province or territory in which it does business. Similarly, an Alberta corporation that
wants to do business in another province or territory can do so by filing the necessary papers with the appropriate authorities.

3.1b Priority over names
Federally incorporated companies do get priority over corporate names. If you want to incorporate under the Alberta system, your proposed corporate name will be rejected if it is the same as or similar to the name of an existing federal corporation.

3.1c Cost
The federal fee for incorporation has always been higher than the fee charged by the Alberta government, and it still is, even though the federal fee was recently reduced from $300 to $250 (by mail, fax, or in person) or $200 online. The Alberta government incorporation fee is $100. You must add to that the fees charged by the private registry outlets in Alberta for processing your papers. Those fees range from $50 to $150.

The fact is that the overwhelming majority of Alberta’s small-business people who choose to incorporate use the Alberta system. If they need to, they can always register their Alberta company in one or two neighbouring provinces when the time comes. Mary and Sally are no different, and the rest of this book follows the process for incorporating in Alberta.

3.2 Two types of Alberta corporations
Technically, there are two types of corporations that can be incorporated under the Alberta system, though as you can see from the explanations below, only one of them applies to Mary and Sally.

3.2a Distributing corporations
These are big corporations that have legal authority and permission to sell (or “distribute”) their shares to the general public, either directly or through a stock exchange. People buy shares in these companies for two reasons: they hope that the value of the shares will go up as the company prospers and they expect to receive a share of the company’s profits in the form of dividends. Sally and Mary aren’t playing in this league, so they won’t use this kind of corporation.

3.2b Non-distributing corporations
These are corporations that do not have authority or permission to sell their shares to members of the general public. Non-distributing corporations are divided into two subgroups: those with more than 15 shareholders and those with 15 or fewer shareholders. The main difference between the two is that non-distributing companies with more than 15 shareholders must file a great deal of financial information for the protection of their shareholders.

Since Mary and Sally, like most Alberta businesspeople who incorporate, will be the only shareholders of their corporation, their company falls into the “15 or fewer shareholders” category of a non-distributing corporation, and that is the sort of company with which the remainder of this book will deal.

3.3 Five different roles you must play
This is the point at which the principle of separate legal entity comes to life. Because the corporation will be a distinct legal creature that can act only through the humans who control it, Mary and Sally must have a clear understanding of the different roles they will need to play. These five roles usually apply to everyone who incorporates a business.

3.3a Shareholder
Shareholders are the owners of the corporation, but they do not own the actual assets of the company. In the case of Sally and Mary, their corporation owns the sewing machines, tables, cloth, supplies, and everything else Mary and Sally will need to carry
What Mary and Sally will own are the shares in the company, and those shares give them three important rights:

i) The right to vote at shareholders’ meetings and elect the directors of the corporation

ii) The right to a share of the profits earned by the corporation in the form of dividends

iii) The right to a share of the assets of the corporation if it is wound up

Mary and Sally must pay for these rights, and they do that by buying the shares from the corporation shortly after it is incorporated. While they may choose to pay a large amount for their shares, and by doing so put a lot of money into the corporation’s bank account to cover its operating costs, it is more likely that they will pay only a dollar or so for each share. That’s because small businesses of this kind do not usually raise the money they need to operate from the sale of shares. Instead, Mary and Sally will probably raise it by borrowing it, either from themselves or from a bank on the strength of a personal guarantee.

As shareholders, Mary and Sally do not have day-to-day control over the operation of their corporation. That power and responsibility is given to the directors. What Mary and Sally do have is the right to elect directors, and to vote them out if they are not doing a good job. Once a year, the directors are required to call an annual general meeting to present information about the corporation’s activities to the shareholders, and if they are dissatisfied they can vote for new directors at that time.

The main concern of shareholders is a simple and quite personal one: they just want to know if they are making any money from their shares. The only liability a shareholder might face is the possibility that the corporation might fail and not be able to repay the shareholder the amount he or she paid for the shares. Minimizing that risk is another reason why Mary and Sally will pay only small amounts for their shares. For more information on shareholder agreements and remedies, see Chapter 4.

3.3b Director

The directors run the company. In a small corporation, they do everything themselves. In a bigger one, they are free to hire managers to look after different aspects of the corporation’s business and report back to them. Sally and Mary will be directors of their corporation and, in the initial stages at least, they will do it all themselves. However, they must realize that directors take on some important responsibilities and liabilities because, unlike shareholders, directors are in a position of trust over the corporation and, to some extent, its employees. They cannot use this position of trust to benefit themselves.

The directors of a corporation, no matter how big or small it may be, must —

i) act honestly and in good faith, in the best interests of the corporation;

ii) exercise the care and skill of a reasonably prudent person;

iii) disclose any personal interest they may have in any proposed contract with the corporation;

iv) not allow the sale of shares for anything except money; and

v) not issue dividends or sell more shares unless the corporation meets the financial tests set by law.

With respect to employees of the corporation, federal tax law says the directors must make sure the corporation sends in the appropriate amounts that must be withheld for income tax and other federal programs for each employee or face personal liability for any unpaid amounts. (Directors are also liable if the corporation does not send in the
necessary amounts for GST.) Also, Alberta law says that directors can be personally liable for up to six months’ wages of employees if the corporation is closed down or goes into bankruptcy.

Finally, environmental laws say that directors may be personally responsible for any damage that the corporation causes to the environment as it carries out its business.

Note that under the Alberta incorporation system, directors must be over the age of 18 years, of sound mind, and not in bankruptcy. Also, a director must be a human: a corporation cannot be appointed director of another corporation.

Sally and Mary need not worry about these responsibilities in the early stages of their business, but as it grows, these areas will become much more important, and they should be aware of them.

3.3c Officer

The directors have the right to appoint officers to handle different aspects of the corporation’s business. President and secretary-treasurer are two of the most common officers found within corporations.

As far as Sally and Mary are concerned, these titles are largely ceremonial. After all, they will be doing all the work themselves and they will be working closely together on a daily basis. But since Sally thought of the original business idea, she will become president, and Mary will be secretary-treasurer. Also, these titles do give credibility to the operation, and banks in particular like to see them when they make loans to small corporations.

3.3d Employee

In any organization, it’s the employees who do the work, and they expect to be paid a fair wage for doing it. Sally and Mary are no different. In the beginning at least, they will be doing everything — taking orders, buying material, sewing product, packing and shipping orders, preparing and sending invoices, collecting payment, depositing and writing cheques — everything that needs to happen to make the business a success. In other words, they will be the employees of the corporation. As directors, they will decide how much they are going to pay themselves, and how often.

3.3e Creditor

As we saw, Mary and Sally will lend money to the corporation so it can cover its operating expenses until it makes enough money to cover them on its own. That makes them creditors of the corporation. This fact becomes important if the corporation can’t repay them. They don’t get special treatment just because they incorporated the business and because they own the shares. Instead, they are in the same position as anyone else who lends money to the corporation. If the corporation fails, all the creditors share equally in the assets of the corporation, although those who have special protection, such as the personal guarantors we talked about, will be paid first, while the rest of the creditors — including Sally and Mary — will share whatever is left over.

3.4 The importance of shares

Shares are the pieces of paper that represent ownership of a corporation, and they carry with them the three main rights mentioned above: the right to vote, the right to a share of the profits, and the right to a share of the assets on the winding up of the corporation.

Each corporation has the right to issue a certain number of shares, and that number is called the authorized capital of the corporation. That number is found in a document called the articles of incorporation, which I’ll discuss in Chapter 2. Most corporations do not issue all the authorized shares, and the number of shares actually issued is called the issued share capital.
In theory, the sale of shares is one of the main ways to raise money, or capital, for the corporation’s operations, but Mary and Sally are not interested in paying large amounts for their shares. Instead, they will be loaning money to the corporation, and they will also be arranging a line of credit through a bank.

3.4a Two classes of shares
It is important to note that a corporation can issue two different types, or classes, of shares. These are called common shares and preferred shares.

Common shares
These are the basic shares that every corporation must have, and this is the type of share we’ve been talking about so far in this book. Common shares must always carry all three of the rights mentioned above: the right to vote, the right to a share of the profits, and the right to a share of the assets on winding up. Common shares are usually referred to as Class A shares.

Preferred Shares
A corporation can also issue preferred shares; shares with extra privileges, called preferences, that the common shares don’t have. Details of the different types of preferred shares and of the special privileges they contain are also found in the articles of incorporation.

One typical privilege of preferred shares is that they allow the incorporators to split the corporation’s income with someone else, usually a spouse, without forcing the incorporators to give up any control over the corporation. The incorporators do that by issuing a class of preferred shares with a preference for payment of a share of the profits, but without any voting rights. Those shares are called Class B shares.

In fact, preferred shares are very flexible and can be designed to suit a number of situations. Each class of preferred shares usually carries one preference, and they are issued in series and called Class B, C, or D shares, as the case may be.

Sally and Mary are not worried about preferred shares right now, but they see that they may need to issue some in the future as the business becomes successful. Therefore, in their articles of incorporation, they are including the right to issue Class B preferred shares.

3.4b Par-value and no-par-value shares
In the past, the value of a corporation’s shares, called the par value, could be fixed in the corporation’s incorporation documents. Shares that did not have this fixed value were called no-par-value shares. You may still hear these terms, but please note that Alberta law abolished par-value shares quite a few years ago, so Mary and Sally’s corporation will have only no-par-value shares. Mary and Sally, as directors of the corporation, will set the value that must be paid to purchase any shares when the shares are issued.

3.5 Pre-incorporation contracts
Since Mary and Sally are already in business, they are presently liable for any contracts they make before the corporation is incorporated. However, they might want to shift liability for any new contracts to the corporation.

For example, they might have a lead on the perfect warehouse and want to nail the space down before someone else does. They should make it clear that they are contracting “on behalf of a corporation to be incorporated,” and should write those words on any document they sign. Doing so will give notice to the people or businesses with
which they are dealing that once the corporation is in existence, it will have the right to ratify and accept the contract. When it does, Sally and Mary will no longer have any responsibility under that contract. If, for some reason, the corporation doesn’t ratify the deal, Sally and Mary remain personally liable. However, as the incorporators, shareholders, and directors, they have the power to make sure it does.

4. Conclusion

There are many reasons why people choose to incorporate their businesses. For Sally and Mary, the decision may come down to nothing more tangible than a conviction that they are going to be successful and a desire to communicate that conviction to the rest of the world. And that is legitimate.

The best advice for anyone considering incorporation is this: if making a living from your business is your main goal, and if you will need all the money from your business to live on, then you don’t need a corporation — yet. But if your business will be earning more money than you need, go ahead.

In the long run, a corporation is the proven choice for those who need flexibility, and incorporating will position you to benefit from the growth of your business in ways that sole proprietorship and partnership cannot.

The rest of this book tells you what to do once you are sure that a corporation is right for you.