SZABO DEVRIES™
BARRISTERS & SOLICITORS
Registered Trade Mark Agents

Incorporating a Company

The Corporation as a "Person"

Under the Business Corporations Act, a corporation is recognized as a legal entity in its own regard, separate and apart from the shareholders or directors of the corporation. As a result, the corporation can own assets, can incur liabilities, can bring legal action in its own name and can be sued as an individual party distinct from its principals. Provincial and federal legislation enables the principals of a corporation to separate their assets from those of the corporation and should the corporation become illiquid or bankrupt, the liability of the shareholders is limited to the amount of their investment, unless they have personally guaranteed the debts or obligations of the corporation.

Taxes

In addition, the corporation is treated by Revenue Canada as a taxpayer, with a rate of tax being assessed depending on whether or not the corporation qualifies as a Small Business Corporation. The corporation would deduct expenses such as salaries as business expenses, and anything left over after expenses is retained by the corporation and is taxed as profit.

If you, as a principal of the corporation, are paid as an employee of the corporation, you would report that salary income and be taxed on it accordingly. If you take any other revenue out of the corporation, other than as a repayment of a shareholders' loan, you may have to pay tax on it. While salaries are a business expense for the corporation, dividends to shareholders are not. Shareholders are entitled to receive dividends of almost $23,700.00 annually without tax liability provided they have no other income. However, dividend income is not treated as earned income and is therefore ineligible to make RRSP contributions.

Income Splitting

Incorporating your company offers some important tax advantages to family members. For example, company income can be split among family members who may be in lower tax brackets by paying them a salary for their involvement in the business in administrative or part-time capacities. Shares can be issued to family members to allow for the payment of dividends. Keep in mind that shares can only be issued for fair market value. If your business is already operational, you may want to consider an "estate freeze" or "rollover". We would be happy to explain this type of transaction to you.

Capital Gains

If your company qualifies as a Small Business Corporation, it may be eligible for the $500,000 capital gains exemption when shares are sold, provided the shares have been owned by the shareholder for at least two years. This exemption enables small business owners to sell their shares on a tax free basis. There are other tax benefits available, such as retirement allowances and individual pension plans. If you would like further information, please contact Szabo & Company.

Directors' Liabilities

The directors of a corporation can be found personally liable in a number of situations. Some of these matters include:

- unpaid employee salaries
- uncollected or unremitted GST
- unremitted payroll deductions
- entering into contractual obligations on behalf of the corporation without clarifying hat they are acting as agent for the corporation
- dealing with shares in the corporation for less than fair market value
- benefiting from undisclosed information to the detriment of other shareholders
- failing to act in the best interests, financially and otherwise, of the corporation
- failing to deal in good faith on behalf of the corporation
- committing any act of fraud, theft or misappropriation of funds

The directors are appointed or elected to conduct the day-to-day affairs of the corporation and to act as its agents. Any contractual obligations entered into by the directors are entered into on behalf of the corporation, and not on their own behalf. Accordingly, they have a legal duty to the corporation and its shareholders, employees and creditors. As such, they are bound by certain obligations, including:

- maintaining a current and thorough knowledge of the operations and affairs of the corporation
- familiarizing themselves with the corporation's articles, by-laws and any shareholder agreements
- voting against any course of action they feel is improper or not in the corporation's best interests
- making full and proper disclosure of any confidential or insider information
- obtaining written advice and opinions of legal, financial and other professional advisors

Shareholder Agreements

Because situations often arise among shareholders which can lead to disputes and sometimes to legal action, it is advisable to put a Shareholder Agreement in place. The Shareholder Agreement can deal with situations such as the death or incapacity of a shareholder, the terms of a buy-out by one partner of another, provisions for bringing on a new partner, and other similar situations. The Agreement can also address such things as:

- confidentiality and non-competition, both during and after involvement in the corporation
- ownership of future business opportunities
- restrictions on management where one party has a controlling interest
- dispute resolution through arbitration

For more information, please contact:

Arthur M. Szabo
Szabo DeVries
#400, 1111 - 11 Avenue SW
Calgary, Alberta T2R 0G5
Phone: (403) 229-1111
Fax: (403) 245-0569
Internet: www.szaboco.com