

Do you think you have a business idea with great potential? Are you tired of job searches that don't get you anywhere? Do you dream of being your own boss? Whatever your reason for starting a business, you think it will be worth it. Whether you're alone or join up with partners, you will have to choose a legal form for your business.

In the following pages, the Quebec Bar Foundation sets out the legal aspects to be considered in making an informed decision about the legal form of your business. More specifically, this booklet will help you understand the advantages and disadvantages of the most common legal forms of business in Quebec.

It will help you decide on the legal status which best corresponds to your situation, your interests and your needs as an entrepreneur. You will also learn what steps should be taken with the government authorities to make your decision to go into business official. ■

your RIGHTS your Business

The Legal Form of Your Business

Choosing the legal form of your business is one of the first decisions you will have to make as an entrepreneur. This booklet gives you an overview of the following legal forms:

1. sole proprietorship
2. general partnership
3. company

The Professional Code also now allows limited liability partnerships to be set up for professionals.

This decision has an impact on the way the business is run, on you as an individual and on your relationships with other people. Knowing the various forms available to you will help you choose which one will best suit your needs.

Although this choice is not irreversible, it is very important to make the right decision when you are starting up your business because changing legal status later is inconvenient and involves additional costs.

The following should be considered in choosing the legal form of your business:

- ★ the number of people who are setting up the business;
- ★ the relationship between you and your business;
- ★ the tax implications and tax rate;
- ★ the entrepreneur's legal liability for the debts of the business;
- ★ the complexity of the steps to be taken;
- ★ the start-up costs.



It's TIME to choose

1. The sole proprietorship

An individual business, often called a sole owner or self-employed worker, is a common legal form. This type of business is very simple and quite inexpensive to create. There is only one person at the heart of the business – YOU.

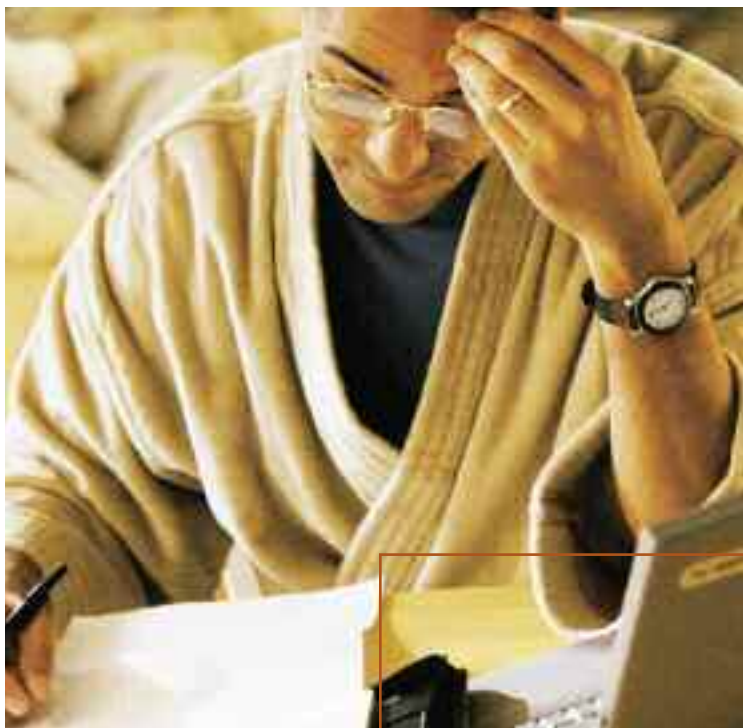
You are thus the only one responsible for its business activities. You are also the only one to enjoy its profits or suffer any losses. A sole proprietorship is often chosen in fields as varied as cosmetology, carpentry, graphics, music, etc.

As a sole proprietorship does not have its own legal personality, you and it are the same entity. This results in the merging of the property of your

business with that in your personal patrimony and at the same time gives you unlimited liability for the debts of the business.

This means that, if your business owes more than it can pay back, your creditors could claim your savings or personal property. In the case of major problems, you could even be forced to declare personal bankruptcy to repay the debts of your business.

As an entrepreneur acting alone, you also have duties. You have to report the income and expenses of your business every year on your personal income tax return. You are therefore taxed on your business profits at the same tax rate, regardless of the source of your income.



optional, as your full first and last names are part of the business name. However, if you set up *Emily's Family Restaurant* or *Helen's Acupuncture Clinic* or *Johnson Consulting*, you will have to fill out the registration form, as these sole proprietorship names do not include both the first and last names of their promoter. Note that the name of the business you choose must not be confusing with that of another business.

For example, Lauren works in a video club part-time. She also sometimes get computer design contracts as a self-employed worker. In her tax return, Lauren will have to declare both her employment income and her business income.

Starting up a sole proprietorship is simple. However, there's one thing you must do – file a declaration of registration with the Enterprise Registrar or at an office of the Quebec Department of Revenue and pay the approximately \$35 fee. By registering, you announce to the government and the public that, as an individual, you are carrying on a business activity which could produce income.

For a sole proprietorship, there is an important exception to the registration requirement. If you carry on your business under your first and last names, you are not subject to this requirement. For example, by running the *John Smith Hardware Store* or the *Jane Doe Optometrist Clinic*, registration is

Am I an INDEPENDENT WORKER or an employee?

WHAT'S THE DIFFERENCE?

The difference between an independent worker and an employee is a question of fact. Although there is no universally accepted definition of independent worker, the government has set up the following five tests which make it easier to determine whether you are an independent worker or an employee:

- Independence vis-à-vis customers:
Do you depend on a single "giver of work" or an "employer"?
Yes No
- The financial aspect:
Do you receive a specific salary even if the business incurs losses or earns substantial profits?
Yes No
- Subordination and control:
Do one or more people supervise your work, tell you what to do or tell you what your work schedule will be?
Yes No
- Ownership of work tools, instruments and equipment:
Are the tools, instruments and equipment with which you work provided by the person who gives you work?
Yes No

• Business relationship:

Are you on the list of employees? Do you go to the Christmas party? Are you part of an employer's group insurance plan?

Yes No

If you answered "yes" to most of these questions, you very likely are an employee. On the other hand, if you answered predominantly "no", it is very likely that you are a self-employed worker.

WHAT DIFFERENCE DOES IT MAKE?

Sometimes a person thinks he is or is considered to be an independent worker whereas in fact he is an employee in the eyes of the government. In such a case, the person and his employer will have to pay a penalty. They will both also have to pay the assessments that weren't paid during the period in which the error occurred. Note also that, contrary to an employee, a self-employed worker is not entitled to employment insurance or automatically entitled to receive compensation from the *Commission de la santé et de la sécurité au travail* and other employment-related benefits.

For more information

Ask for the brochure "Are You a Self-Employed Worker?" from a Revenue Quebec office or the brochure "Employee or Self-Employed?" from a branch of the Canada Customs and Revenue Agency

Comparative Table

Advantages

Disadvantages

Sole Proprietorship	General Partnership	Company
<ul style="list-style-type: none"> ❖ Low cost ❖ No formalities required to set it up ❖ Easy to run 	<ul style="list-style-type: none"> ❖ Inexpensive (other than a lawyer's fee for drawing up the partnership contract) ❖ Few formalities required to set it up ❖ Easy to run: governed by the partnership contract and the law ❖ Pooling of money, time, knowledge and expertise 	<ul style="list-style-type: none"> ❖ Personal liability of the shareholders limited to their investment (subject to personal guarantees granted by the shareholder) ❖ Lower tax rate than for individuals
<ul style="list-style-type: none"> ❖ Unlimited personal liability of the entrepreneur for any debts ❖ Tax rate equal to that of individuals and higher than that of a company ❖ Death of the entrepreneur means the end of the business 	<ul style="list-style-type: none"> ❖ Unlimited personal liability and solidary liability of the partners for the debts ❖ Tax rate equal to that of an individual and higher than that of a company 	<ul style="list-style-type: none"> ❖ Most costly due to the incorporation fee and the legal fees for incorporating the company and drawing up a shareholders' agreement ❖ Several formalities involved in setting it up ❖ More complex to run and governed by laws and internal by-laws



2. The general partnership

To set up a partnership, two or more individuals agree, verbally or by written contract, to run the business together. The partners also agree on the sharing of profits and the contribution and pooling by each of the partners of their time, property and knowledge.

For example, Brent and Nadine agree to start a new publishing company. They both agree to invest \$10,000 cash in the project. They also set out in writing their respective responsibilities in the business as well as the way they intend to share the profits. Brent and Nadine set up a partnership. They are partners.

There are three types of partnerships: general partnerships, undeclared partnerships and limited partnerships. As the last two are less common than the first, this booklet will only cover general partnerships.

The choice of a general partnership as the legal form of a business has effects similar to those of a sole proprietorship. Firstly, like a sole proprietorship,

a general partnership does not have its own legal personality. Although it is related to the partners forming the partnership, it has a separate existence from them. Like a company, a general partnership has its own property, holds rights and must comply with certain obligations. It is with respect to the partnership's debts that the partners are intimately related

to it – they have unlimited liability for the debts of the business.

For example, in setting up the partnership *B.A.N. Publishing, G.P.*, Brent and Nadine have unlimited liability for its debts. If the business runs into financial trouble, their personal property will be “made available” to the business. As a result, Brent and Nadine may have to dip into their personal savings to pay the debts of their business.

One important feature of a general partnership is that, in addition to having unlimited liability for the partnership's debts, the partners are also solidarily liable among each other. This means that each of the partners may be required to pay all the debts of the

business, not just half, if there are only two partners. Many people wrongly think that creditors can only claim their share from them. To find out more about several liability, read the box on this page and *Booklet 2 “Your General Partnership Contract”*.

As it does not have its own legal personality, a general partnership does not have to file an income tax return separately from its partners. However, it must keep records which will allow it to draw up annual financial statements. At the end of the fiscal year, the earnings from your business will be distributed among the partners, and the portion you receive will have to be included in your personal income tax return.

To legalize this form of business, you simply have to file a declaration of registration with the Enterprise Registrar or Revenue Quebec and pay the approximately \$40 fee. Unlike a sole proprietorship, the declaration of registration is mandatory for a general partnership and there is no exception, regardless what the name of the business is.

A general partnership must contain the words “General Partnership” or the acronym “G.P.”, as the law requires that it indicate its legal form when it carries on business. One of these must be added to contracts, bank accounts, cheques and all official documents. For example, one would refer to *Jones and Lawrence, Caterers, General Partnership* or *Jones and Lawrence, G.P.* Don't forget that the business name you choose must not be confusing with that of another business.

3. The company

A company, which is also called a business corporation or legal person, may be set up by one or more people. Contrary to a sole proprietorship or general partnership, this form of business has a separate legal personality from its founders, shareholders and directors.

The separate legal personality has major implications. A company has its own rights and obligations. It has a separate patrimony from those who set it up. As a result, it is not true, as many shareholders think, that they own the company's property. The company owns its property, and the shareholders only own the shares they hold.

The effect of choosing a company as the legal form is to limit the shareholders' liability to their investment. This choice therefore means that you will have less liability than in the case of a sole proprietorship and general partnership. For example, if *Bike Rentals Inc.*, goes under because of its debts, in theory, its shareholders Maude and Louis will not be required to pay them personally, except in the serious case of fraud or abuse of right. If the company goes bankrupt, they will only lose what they both invested in the company.

However, financial institutions and other investors often require that the shareholders personally guarantee the loans necessary to start up the company. In this case, you will act as a guarantor and might have to personally honour some of the company's debts and pay them for the company. Although the amount and term of the guarantee are fixed, this is a common thing for investors to do in order to minimize the risks inherent in financing a company without a financial

history. The advantage of your limited liability as a shareholder is thereby decreased. Over the years, as soon as the company shows some stability and profits, you can ask the financial institution to reduce your personal guarantees.

With respect to its obligations, a company must prepare its own income tax return

annually. The profits it has earned are taxable at a rate of approximately 22%, which is much less than the tax rate for individuals applicable to the legal forms we examined above.

However, a company has some disadvantages too. Its setup and operation are much more complex than that of a sole proprietorship or a general



What is **SOLIDARY** liability?

THE LAW IS CLEAR

The partners of a general partnership have unlimited liability and are solidarily (sometimes called “severally”) liable for the partnership's debts. For example, a supplier of the business *Rare Books, G.P.*, which was not paid the \$15,000 the partnership owed it, can claim it from one of the three partners. The creditor may therefore choose which of Peter, Paul or Mary will have to pay the debt. If Paul is chosen, he will have to pay the creditor the \$15,000 and then ask his partners to reimburse him their share of the debt.

CAN YOU REDUCE THE EFFECTS OF SOLIDARY LIABILITY?

A clause in a partnership contract which limits a partner's liability with respect to the partnership's debts cannot be set up against third parties. In our example above, even if Paul had negotiated a clause limiting his liability to 25% of the debts, he would not have been able to impose it on the creditor and only pay one-quarter of the debt. Like any partner of a general partnership, Paul will therefore have to pay the entire debt and then claim what is owed to him from the other partners.

For more information, see Booklet 2 “Your General Partnership Contract”.

partnership. If you are not familiar with the workings of a company and the laws governing it, you may find the requirements complex. To confirm your choice and set up a company, a lawyer can help you figure things out and choose the type of company best suited to your needs. As you may know, there is more than one type of company. A company may be incorporated provincially or federally.

✿ Setting up a provincial company

You or your lawyer must incorporate it, i.e. obtain a certificate confirming that the company has been incorporated. A provincial company is incorporated through the filing of what are known as *articles of incorporation*. The filing of articles must be accompanied by a search report confirming that the name chosen for your company is not already being used by another business. The search report involves costs and can be obtained two ways: either by using Form 3 or through a firm specialized in name searches. To find such a firm, look in the yellow pages under the heading “*Searchers of Records*”.

Also, within 60 days of its incorporation, the company must file with the Enterprise Registrar an initial declaration which serves as its registration and replaces the declaration of registration. There is no charge for the initial declaration if it is filed within 60 days of incorporation. After that time, a fee of approximately \$75 is charged.

✿ Setting up a federal company

A federal charter is applied for by filing of articles of incorporation, i.e. Forms 1 and 2. The filing of the application must be accompanied by a search report from a recognized search company. The cost of such a report is approximately \$115.

Lastly, whether you have decided on a federal or a provincial company, a company which does not have a corporate name will be given a corporate number (ex.: 8000-000 *Québec inc.* or 12345678 *Canada Inc.*). When choosing your company name, don't forget that it must contain the word “Company” or be followed by the abbreviation “Ltd.” or “Inc.”, for example: *Brown's Travel Agency Inc.*

If you are interested in finding out the main features of a provincial or federal company, see the box “*Should I incorporate a provincial or a federal company?*” in this booklet. To find out more about the legal form of a company, see *Booklet 3 “Your Shareholders' Agreement”*. ■

REMINDER

- ✓ If you start your business alone, your choice will be between a sole proprietorship and a type of company.
- ✓ If two of you want to set up a business, choose between a general partnership and a type of company.
- ✓ Unless you are an individual running a sole proprietorship under your first and last names, all businesses must be registered with the Enterprise Registrar.
- ✓ In theory, a registration fee must be paid for every type of business and is payable annually.
- ✓ If you choose a sole proprietorship or a general partnership, you will be personally liable for the debts of your business.
- ✓ The name of your business must be distinctive and not be confusing with that of another business that already exists.

IF YOU NEED HELP

Enterprise Registrar

2050 Bleury, 4th Floor
Montreal QC Tel.: 1 877 644-4545
www.registreentreprises.gouv.qc.ca

Industry Canada – Corporations Canada

5 Place Ville-Marie, Suite 800
Montreal QC H3B 2G2 Tel.: (514) 496-1797
www.ic.gc.ca

Revenue Quebec

Complexe Desjardins, P.O. Box 3000, Succ. Desjardins
Montreal QC H5B 1A4 Tel.: (514) 864-4155
www.revenu.gouv.qc.ca

Canada Customs and Revenue Agency

305 René-Lévesque Blvd. W.
Montreal QC H2Z 1A6 Tel.: 1 800 959-7775
www.ccr-a-adrc.gc.ca

Commission des normes du travail (CNT)

2 Complexe Desjardins, P.O. Box 730, Succ. Desjardins
Montreal QC H5B 1B8
Tel.: (514) 873-7061 • 1 800 265-1414
www.cnt.gouv.qc.ca

Commission de la santé et de sécurité au travail (CSST)

1 Complexe Desjardins, South Tower 34th Floor
P.O. Box 3 Succ. Desjardins
Montreal QC H5B 1H1 Tel.: (514) 873-3990
www.csst.qc.ca

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Should I **INCORPORATE** a provincial or a federal company?

When you decide on a company as the legal form of your business, the choice does not stop there. As there is a provincial law and a federal law governing companies, you must also choose which one will apply to your business. Several things should be kept in mind when making this decision.

THE GEOGRAPHICAL EXTENT OF YOUR ACTIVITIES

A federal company will allow you to do business throughout Canada and around the world without any restrictions or additional requirements. A provincial company will also allow you to do business in Quebec as well as in any other country; however, if you want to do business in one or more other Canadian provinces, you will have to obtain authorization to do so, which will cost between \$75 and \$500, depending on the province.

LOCATION OF YOUR HEAD OFFICE

A federal company can have its head office anywhere in Canada, whereas a provincial company must have its head office in Quebec.

INCORPORATION AND COST

A federal company must be incorporated with Corporations Canada and the cost is approximately \$250 (excluding your lawyer's fee). A provincial company is incorporated by the Enterprise Registrar. The cost is approximately \$300 (excluding your lawyer's fee).

As each business is different and there are several nuances between the provincial and federal statutes, you are advised to consult a lawyer. It would be unwise to decide based only on the cost of incorporation and disregard the consequences on the operation and growth perspectives of your company.

GOVERNMENT REQUIREMENTS

Other than the formalities relating to the legal form, a business must comply with the requirements of three levels of government: municipal, provincial and federal.

1. Municipal

Ask at your municipality's permit office about zoning rules and the operating permits you will need, such as a certificate of occupation or sign permit.



2. Provincial

Ask about the registration application at a Quebec Department of Revenue office and fill out Form LM-1. This application is used as your registration for the purpose of the Quebec sales tax ("QST"), the goods and services tax (GST) and to obtain a deduction at source number and a corporate tax number.

If you have employees, don't forget to inform the *Commission des normes du travail* and the *Commission de la santé et de la sécurité au travail*.

3. Federal

Get information from the Canada Customs and Revenue Agency and fill out Form RC57-E, which will give you a corporate income tax number, a deductions at source number and an importer or exporter number.

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**The information found in this booklet is general and does not constitute a legal opinion.
If you have specific questions or a legal problem, don't hesitate to consult a lawyer.**

In this text, the masculine form is used to refer to both men and women.

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