



INCORPORATION 101

Part III: Running your Corporation

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In the short time I've been practicing law I've come to realize that most clients incorporate their small business to take advantage of favourable tax rates and limited liability, but change nothing else in their operation. There's a lot more to incorporating than meets the eye however, so this week in Part III of our series I'll set out some basic rules for running your corporation. If followed, these rules will help you to avoid problems with the Canada Revenue Agency and to maintain limited liability.

First however, we need to understand the tax advantages to incorporating and the concept of limited liability. As mentioned above, Canadian corporations pay lower rates of tax than individual citizens. Corporations can also keep a certain percentage of their annual income invested in the corporation, and don't have to claim this income in the tax year it's earned, but can claim it later at a more favourable time.

As mentioned in Parts I and II, Corporations are also limited liability entities, meaning that if a corporation experiences

financial problems or is sued, only the corporation's assets are at risk. In these circumstances Creditors and Plaintiffs cannot seek repayment or judgement from the corporation's shareholders, officers and directors personally. Because of this advantage many small business owners incorporate in order to protect their hard earned personal assets.

Together, these tax advantages and limited liability are intended to encourage investment in business and thus stimulate economic growth. However, these tax benefits and limited liability are not guaranteed once you incorporate. To ensure that you don't run into trouble with the Canada Revenue Agency or risk becoming personally liable, your corporation must be operated like a corporation, and not like a sole proprietorship or partnership. As such, here are some basic rules for running a corporation:

- 1) **Make sure the world knows you're operating a corporation**, by using

the Corporation's proper name, including the term Corporation, Incorporated or Limited, or one of their abbreviations. These terms serve as notice to outsiders that they're dealing with a limited liability entity, and that if problems arise their remedies against the company are limited.

- 2) **Use the corporation's name on all documents**, and ensure you sign the documents as an officer of the corporation, not as yourself. For example, the corporation's name (not your own) should be used on all quotes, receipts, contracts, bills of sale, etc.
- 3) **Perform all banking in the corporation's name**. Specifically, all bank accounts, lines of credit, cheques, and credit cards, etc. should be in the corporation's name, and should not be used for personal purposes. Even if you are the sole shareholder,

director and officer of the corporation its money is not yours to spend. Instead, the corporation should either pay you as an employee or declare dividends.

- 4) **Ensure the corporation is insured.** Liability, property, content, etc. insurance should all be purchased in the corporation's name.
- 5) **Make the appropriate remittances.** While you were previously the business' owner and the boss, you are now an employee of the corporation. As such, you need to deduct and remit money from you income for Employment Insurance, Canada Pension Plan, Workers Compensation, etc.
- 6) **Pay yourself and your family at fair market value.** When operating an unincorporated business you're free to pay yourself and your family members more than fair market value. When you operate a corporation however, all

of your actions must be in the best interest of the corporation, and as such you must pay all employees at fair market value. Remember that if you wish to make more money, you always have the option of declaring dividends.

- 7) **Remember that you're now a Director and not just a Parent or Sibling.** When you're operating a family business personal issues often affect how you relate to one another and conduct business. Once your family members become shareholders however, you cannot allow personal issues to cloud your business judgement because all shareholders have legal rights and must be treated fairly.
- 8) **Keep good records.** Keep written records of all changes regarding the shareholders, directors, and officers, and keep track of all decisions made by the shareholders and directors (resolutions).

This information should be contained in the company's minute book, along with the Articles of Incorporation and By-laws, and stored at the corporation's registered office.

For a more in depth discussion of how incorporating will affect you and your business, be sure to contact your lawyer and accountant.