

GUIDE TO DOING BUSINESS IN CANADA: BUSINESS STRUCTURES

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Business structures

There are three basic structures available: sole proprietorship, partnership and corporation. Foreign businesses may also conduct business within Canada through branch operations or a joint venture. As is the case in most common law jurisdictions, a person or entity wishing to operate a business in Canada can choose from several different business structures. The appropriate structure is determined on a case-by-case basis depending on the nature and location of the business, liability and general issues of exposure, the entity's financing requirements, and tax considerations.

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1. Sole proprietorship

A sole proprietorship is typically used when the business is owned and operated by the individual responsible for the business and its liabilities.

This structure is extremely simple, with few legal complications. However, some requirements, such as licensing and business name registrations, will still apply. This structure is best suited for small enterprises, as all benefits and liabilities of the business

flow through to the individual.

One shortcoming is that the liability of the enterprise is the same as the liability of the individual operating the business. Unlike a corporation, assets of the sole proprietor are at risk in honouring the liabilities of the business. Another shortcoming is that opportunities for tax planning are limited, as the profits of the business flow through to the individual and are taxed in his or her hands.

2. Partnership

A partnership exists when two or more individuals or corporations carry on business together with a view to profit. In Canada, the provinces have exclusive jurisdiction with respect to partnerships and, accordingly, each province has enacted its own specific partnership legislation.

All provinces recognize general partnerships and limited partnerships. For tax purposes, a partnership is not recognized as a distinct entity. Rather, the profits and losses of the partnership flow through, on a proportionate basis, to the partners, who must pay tax on these amounts in their personal tax returns.

a. General partnership

In the common law provinces (all provinces excluding Quebec), a general partnership may be formed even if there is no written declaration of the partnership. In a general partnership, each partner is liable for the debts and obligations of the partnership on an unlimited basis.

In Québec, a partnership is formed by a contract by which two or more individuals or corporations agree to carry on an activity, which may be the operation of an enterprise by providing property, knowledge and/or activities, and by sharing profits. Further, creditors must first seek reimbursement from the property of the partnership; the personal property of a partner is not applied to the payment of creditors of the partnership until that partner's own creditors have first been paid.

b. Limited partnership

A limited partnership is composed of at least one general partner and any number of limited partners. General partners manage the affairs of the partnership and are liable to

an unlimited extent to creditors of the partnership. Liability of the limited partners is limited to the amount of capital contributed. Limited partners must not participate in the management of the partnership, or they risk losing their limited liability.

c. Limited liability partnership

In some provinces a limited liability partnership is available, although typically only to groups of professionals such as lawyers, accountants and doctors. These limited liability partnership agreements are governed by specific provincial legislation and, as the name implies, give the partners more liability protection than they would have as general partners. Only the assets of the partner whose actions gave rise to a liability are at risk, not the assets of all the partners, as would be the case if they were all general partners.

d. Undeclared partnership

Québec also recognizes undeclared partnerships, which are de facto partnerships that are deemed to exist even though they are not registered in the manner prescribed by legislation concerning the legal publicity of enterprises.

Each partner retains ownership of the property constituting the partner's contribution to the undeclared partnership. Partners are also liable for the debts and obligations of the other partners on an unlimited basis, provided the debts have been contracted for the use or operation of the common enterprise.

3. Corporation

A corporation is a legal entity distinct from its shareholders. In Canada, a corporation is endowed with all the legal abilities of a natural person in that it can own property, carry on business, borrow, lend, sue or be sued.

Shareholders of the corporation do not own the business or assets of the corporation and, except in certain exceptional circumstances, are not personally responsible for its liabilities. Corporations offer limited liability, ease of transfer of assets and perpetual existence. Since a corporation is a distinct legal entity, it must pay tax on its income. The corporation is by far the most common business structure in Canada.

a. Incorporation under federal or provincial law

A corporation may be created under either federal or provincial law. The decision of which jurisdiction to incorporate under typically depends on i) the jurisdiction(s) in which the business will operate; (ii) director residency requirements; (iii) corporate name requirements and (iv) cost. Companies that wish to carry on a business subject to federal regulation must be incorporated under federal law, and sometimes - such as in the case of banks - under industry-specific legislation. In addition, particular local nuances in the provincial statutes may result in a foreign investor favouring federal incorporation. If a company intends to operate in more than one province or territory, it will need to register in each province and territory in which it conducts business, regardless of the jurisdiction of incorporation. If a company intends to operate in more than one province or territory, it will need to register in each province and territory in which it conducts business, regardless of the jurisdiction of incorporation.

Public disclosure

The scope of public disclosure required of a corporation varies widely depending on the jurisdiction of incorporation, the type of business being conducted and whether the corporation is a public offering or non-offering entity.

b. Officers, directors and shareholders

In Canada, as in other common law jurisdictions, a corporation is composed of three groups: officers, directors and shareholders. In small private corporations, the same individual or individuals may, at different times, act in all three capacities. In public corporations, this is typically not the case.

The officers of a corporation are responsible for the daily management of its affairs. The directors of the corporation appoint the officers, and the shareholders of the corporation elect the directors. While the board of directors is not responsible for the day-to-day affairs of the business, it is charged with managing the business of the corporation. There are liabilities attached to the office of director, but insurance may be purchased to shield members of the board from certain liabilities.

c. Residency requirements

Foreign investors must consider residency requirements. The federal statute requires that at least 25 per cent of a corporation's directors be resident in Canada. Where there are fewer than four directors, the Canada Business Corporations Act requires that one director be resident in Canada. Each province has different residency requirements that

investors wishing to incorporate in Canada should consider. It is of particular interest to note that there is no residency requirement for directors of corporations established under the business corporations acts in British Columbia, Nova Scotia, New Brunswick, Prince Edward Island and Quebec.

d. Unlimited liability companies

An unlimited liability company (ULC) can be incorporated under the provincial laws of Alberta, British Columbia and Nova Scotia. Unlike shareholders of other corporations, shareholders of a ULC are personally liable for the liabilities of the company. These entities are generally used by foreign investors to gain advantageous tax treatments. Though ULCs are taxed as corporations in Canada, they are eligible for "check-the-box" election in the United States and may be taxed as either a corporation or a flow-through entity.

4. Branch operations

A foreign corporation may conduct business within Canada through a branch operation after obtaining a licence or otherwise registering in the province(s) where it carries on business. Although the definition of "carrying on business" varies from province to province, a corporation may be found to be carrying on business if:

- It has a resident agent, representative, warehouse, office or place where it carries on its business in a province.
- It holds an interest in real property located in a province other than by way of security.
- The type of business to be carried on is one that the province has chosen to regulate.

Generally, a corporation is not deemed to be carrying on business in Canada merely because it takes orders for, buys or sells goods, wares and merchandise, or offers or sells services of any type by use of travellers or through advertising, correspondence or the Internet. Branch offices are popular because they enjoy certain tax advantages. However, because a branch office is not a legally distinct entity from the parent company, the parent will be exposed to the debts, liabilities and obligations of the Canadian operation.

There are penalties for failure to obtain a licence where required. Furthermore, without a licence, a foreign corporation might not be capable of maintaining a proceeding in a court or tribunal in respect of a contract made by it. The procedure for obtaining a licence is

generally uncomplicated, provided the name of the corporation is not similar to that of any other corporation or business entity in the same jurisdiction.

5. Joint venture

The term "joint venture" describes any arrangement where two or more persons agree to contribute goods, services or capital to a common commercial enterprise.

With no statute currently governing joint ventures in Canada, they are governed by the contracts arrived at between private parties. The terms of collaboration, the nature of co-venturers' respective contributions and the arrangements regarding management and sharing of profits are typically set out in the contract.

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