

# Week 3- Module 3

Business Organisations

Law, Ethics and Professional Practice -

ENGI3500

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# Introduction

- Through collaboration with clients, suppliers, and stakeholders, engineering businesses establish networks that facilitate knowledge exchange and contribute to the profession.
- Various types of businesses in engineering, including but not limited consulting firms, manufacturing companies, and research institutions are formed with unique and specific legal structures and tax implications.
- Understanding the three fundamental types of business organizations, namely **sole proprietorships**, **partnerships**, and **corporations**, is crucial for engineers to grasp their legal rights and liabilities.

# Three Types of Businesses Organisations

- **Sole proprietorships**
- **Partnerships**
- **Corporations**

# Basic Forms of Business Organisations

- **Sole Proprietorship:**

Within a sole proprietorship, as implied by its name, an **individual** conducts business independently.

- The proprietor directly experiences both the **gains** and **losses** of the enterprise on a personal level.

# Basic Forms of Business Organisations

- **Partnerships:**

A partnership is a collaboration of individuals or entities engaged in a shared business venture aimed at generating profits.

- In a partnership, the participants jointly bear the financial outcomes, experiencing both **gains** and **losses** on an individual basis.

# Basic Forms of Business Organisations

- **Partnerships:**

The perceived benefit of a partnership lies in the synergy created by pooling the resources and skills of its members, however risk is associated with partnerships is the potential accumulation of significant debts, which could lead to the partnership being unable to settle its obligations.

Consequently, creditors of the partnership may seek judgments against the **personal assets** of the individual partners.

# Basic Forms of Business Organisations

- **Corporations:**

The corporation stands as a separate entity, independent of its shareholder proprietors.

- Often referred to as a "fictitious person," the corporation possesses its own assets and is accountable for its distinct liabilities.
- It holds the capacity to initiate legal actions or face litigation in its own name.

# Basic Forms of Business Organisations

- **Corporations:**

Interestingly, a shareholder within a corporation retains the ability to engage in contracts with or pursue legal actions against the corporation.



# Corporate Entities

- The recognition of a corporation as a **distinct entity** from its shareholder-owners, along with the fundamental principle that the corporation's obligations are its own and not the responsibility of its shareholders, has been firmly acknowledged by the **Canadian judicial system.**

# Corporate Entities

- This distinct corporate identity serves as a compelling motivation for individuals to opt for incorporation rather than continuing as sole proprietors or partners, as the personal assets of sole proprietors and partners are susceptible to potential claims from business creditors.

# Let's think through this scenario...

Imagine that you are thinking about starting a business in a few years: would you want to opt for an incorporation, partnerships or sole proprietorships? Which type of business would you use and why?

# Corporate Entities

	Sole proprietorship	Partnership	Corporation
<b>Legal status</b>	Does not exist as a separate legal entity. Proprietorship = ownership	Does not exist as a separate legal entity. Partnership = partners as owners	Corporation is treated as a separate legal entity from its owner. Corporation = shareholder ownership
<b>Control</b>	Owner has total control.	Partners' agreement determines control between partners.	Directors and shareholders.
<b>Profits</b>	Profits are paid to the owner.	To partners according to a partnership agreement.	Earned by the corporation. Dividends may be paid to shareholders and/or retained in the corporation.
<b>Debts</b>	The owner is responsible (unlimited liability).	Partners are individually and collectively responsible.	Paid by the corporation.
<b>Taxation</b>	The owner is taxed as an individual on the income of the business as if he or she was employed.	Partners are taxed individually according to their share of the income.	The corporation pays corporate taxes separately from taxes paid by directors and shareholders.
<b>Assets</b>	Business assets are wholly owned by the proprietor.	Partners jointly own business assets and/or ownership is governed by partnership agreement.	Business assets are owned by the corporation. There is no specific claim on the corporate assets by shareholders.

(Business Development Bank of Canada, n.d.)

# Tax Considerations

- The basic combined federal and provincial corporate income tax rates vary among provinces and territories. A Canadian controlled private corporation ("CCPC") for purposes of the Income Tax Act (Canada) will generally be eligible to receive a credit in respect of its tax otherwise payable on income from an active business carried on in Canada.
- When the corporation distributes its after-tax income to its shareholder or shareholders by way of dividends, each shareholder who is an individual must pay a tax on such dividend income and is entitled to a dividend tax credit.

# Tax Considerations

- In some cases, the effect of the small business deduction is that the aggregate of the tax paid by the corporation entitled to such deduction on the income earned by it and the tax paid by the individual shareholder receiving the dividend is less than the tax would have been paid had the business been carried on through a sole proprietorship. In other words, dividend income from a corporation can result in less tax payable than does income derived from a sole proprietorship or partnership.
- In addition, there is a timing advantage available. The taxes paid by shareholders on corporate dividends are payable only when dividends are paid by the corporation. If the board of directors of the corporation chooses to defer the payment of dividends to a subsequent taxation year, then the tax payable on that dividend is deferred.

# Partnership Agreements

- When entering a partnership, it is crucial to establish and formalize the terms through a detailed partnership agreement to look for:
  - outlining management responsibilities
  - profit and loss sharing
  - working capital contributions
  - dissolution procedures
  - partner withdrawal or expulsion criteria.

# Partnership Agreements

- Due to the personal nature of partnership obligations, seeking legal counsel for drafting the partnership agreement is advisable. Each partner should ideally obtain independent legal advice to ensure a comprehensive understanding of the agreement.
- While partnerships typically involve individuals, organizations such as corporations may also engage in partnerships, with each corporate partner's assets being at risk. The proposed partnership's purpose should be carefully evaluated to justify the associated risks.



# Limited Liability Partnerships

- In the realm of engineering, '**Limited Liability Partnerships**' (LLPs) are accessible to professionals in several provincial jurisdictions.
- These partnerships effectively restrict individual partners' liabilities to their own, safeguarding each partner from the liabilities incurred by other partners.
- Legislation governing partnerships, including in Ontario and other regions, mandates that Limited Liability Partnerships secure professional liability insurance coverage.

# Incorporation

- Corporations can be formed through federal or provincial legislation, such as the **Canada Business Corporations Act** or the **Business Corporations Act of Ontario**, with the process resulting in incorporation being essentially the same.
- Both federal and provincial corporations have the capability to conduct business beyond the geographic limits of their respective jurisdictions of incorporation.

# Incorporation

- When deciding between federal or provincial incorporation, considerations include the intended geographic scope of business operations.
- Federal incorporation may be suitable for those planning to operate nationwide, while provincial incorporation, such as in Ontario, may be advisable for businesses with a more limited regional focus.
- Additionally, businesses incorporated in Ontario and Quebec benefit from a reciprocal arrangement, allowing them to operate in each other's provinces without obtaining other provincial licenses.

# Public vs. Private Corporations

- - A distinction exists between "private" or closely held corporations and "public" corporations, the latter of which offers shares to the public following securities legislation and stock-exchange regulations.
- A "private" company is generally characterized by restricted share transfer rights, a shareholder limit not exceeding 50 (excluding present and former employees), and a prohibition on public invitations to subscribe for its securities.
- Many engineering corporations initially begin as private entities, with the option to transition to a "public" status, requiring ongoing adherence to comprehensive disclosure and reporting obligations under provincial securities legislation.

# Roles of Shareholders, Directors, and Officers

- Shareholders, acting as the corporation's "owners," obtain share certificates as proof of ownership through their investment in the company.
- Shareholders exercise their ownership role by electing directors who, in turn, oversee the corporation's affairs and business management. Additionally, officers appointed or elected by the directors typically handle day-to-day business operations, with their specific duties outlined in the corporation's by-laws.

# Roles of Shareholders, Directors, and Officers

- Establishing a shareholders' agreement is crucial for shareholders of closely held corporations, addressing key matters such as board nominations, shareholder responsibilities, share selling criteria, trade secret protection, and prevention of dilution, as it safeguards against disputes and potential detrimental consequences arising from conflicts among shareholders.

# Joint Ventures

- Joint ventures are increasingly favored by contractors, engineers, and architects for large-scale projects, functioning essentially as project-specific partnerships.
- To protect joint venturers' assets, it is important to limit the scope of the joint venture to the single project at hand.
- Joint venturers should indemnify each other for potential liabilities arising from negligent performance, and the joint-venture agreement should precisely define the project scope, outline obligations, and establish the sharing mechanism for revenues and costs.

# Conflicts of Interest

- Directors, in fulfilling their fiduciary duty to the corporation, are obligated to act in its best interests and in good faith. Moreover, statutory requirements mandate directors to disclose any personal interest in significant contracts or transactions involving the corporation.
- Failure to disclose such interests prohibits directors from voting on these matters, and if undisclosed, directors may be held accountable to the corporation or its shareholders for any personal gains resulting from the contract or transaction.
- In engineering companies, the importance of transparent disclosure of conflicts of interest is paramount, ensuring ethical conduct, preserving trust, and aligning with legal obligations.



# Homework Before Next Class

- From the textbook:
  - Chapter 2: Business Organizations
  - Chapter 3: Global Considerations
- Take notes in your logbook and create a lesson summary.

# THANK YOU.



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# References

Business Development Bank of Canada. (n.d.). *Advantages of different business structures*.  
<https://www.bdc.ca/en/articles-tools/start-buybusiness/start-business/advantages-different-business-structures>

Marston, Donald L. 2019. *Law for Professional Engineers: Canadian and Global Insights*. 5th ed. New York: McGraw-Hill Education.