

The Role of the Legal Advisor

Prepared For: Legal Education Society of Alberta

Advising a Private Family Business

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For Presentation In:

Edmonton – Nov. 27, 2012

Calgary – Dec. 4, 2012

THE ROLE OF THE LEGAL ADVISOR

A. BUSINESS STRUCTURES

Many of us act for long established family businesses which originally may have been set up as proprietorships or partnerships and which have grown and evolved into relatively large, or at least relatively profitable, corporations. This section will review the forms of business structures available with a focus on those with which you will deal with most often when advising family businesses.

1. Sole Proprietorships

Of most import is that there is no legal distinction between a sole proprietor and his/her business:

- For income tax purposes all income is therefore attributable to the individual. The corollary is that losses from the business, provided that the business has a reasonable expectation of profit, may be used to reduce other income earned (subject to restricted farm loss rules and loss carryovers).
- For liability purposes the individual's whole basket of personal and business assets is available to satisfy creditors of the business.

The most common question we face when an individual approaches us for advice on starting up a business is whether to incorporate. In many circumstances, the simplicity of the sole proprietorship favours its choice at least until the business has been shown to be viable. I often recommend to clients that they use their start up capital for direct business purposes as opposed to incorporation costs, even though such costs are relatively nominal.

Perhaps the second most common question relates to registration. Only individuals trading, manufacturing, contracting, or mining under a name other than their own or under their own with the addition of "and company" or something similar indicating a plurality of members (though not partners) need to register. (*Partnership Act* (Alberta), s. 110). Of these four categories, "trading" and "contracting" are the broadest and may encompass the operations of many sole proprietors. But in our experience most people want to register their operating name regardless of the need

to do so, and often banks require them to do so if they want an account in a business name.

2. Partnerships

Surprisingly, though most of us belong to professional partnerships, it is not a form of business organization that we readily recommend to clients.

Because a partnership is a relationship between persons that exists without legislation, the *Partnership Act* merely codifies the major principles of law developed over centuries of jurisprudence. That includes the principle that a partnership is a relationship (s. 1(g)) as opposed to a separate legal entity. So as is the case with proprietorships:

- For income tax purposes all income is determined at the partnership level but income and losses are then attributable to the respective partners.
- For liability purposes a partner's whole basket of personal and business assets is available to satisfy creditors of the business. An exception is contained in the Limited Liability Partnership provisions of the *Partnership Act* (s. 12), but it has limited application to family businesses other than law or medical practices.

Section 1(g) of the *Partnership Act* assists in the determination of whether a partnership or some other form of relationship exists. The general principle from the case law and section 1(g) of the *Partnership Act* is that a partnership relationship requires something more than common ownership of an income producing asset, so effectively it requires the operation of a business. Prudent advice to clients who approach you with a business or investment idea therefore requires that you explain the distinction between relatively passive ownership of an income producing property and the more active carrying on of a business. In either case, a written agreement should be negotiated to determine the involvement of the parties based on the criteria set out in section 4 of the *Partnership Act*.

It is prudent in any event to recommend a written agreement so that the death of an individual partner does not result in dissolution of the partnership (*Partnership Act* s. 37(1)(a)).