

Under Pressure: Taking Time to Consider Corporate Law Issues When Structuring Family Law Settlements

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Business Issues in Family Law Matters

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**UNDER PRESSURE: TAKING TIME TO CONSIDER CORPORATE LAW ISSUES
WHEN STRUCTURING FAMILY LAW SETTLEMENTS**

1. INTRODUCTION

When faced with separation from a spouse or a common law partner (generally referred to herein as a “partner”), clients are often anxious to get through the process and sever ties with their partner as quickly as possible. Being under this pressure, clients sometimes agree to a settlement only to later find out that the settlement terms cannot be given effect from a corporate law perspective. Not only does this cause additional delays in the separation process, it can also expose lawyers to liability in the event that the terms of the agreed settlement cannot be achieved due to the corporate law issues.

Even though family lawyers often engage corporate lawyers to assist with the implementation of family law settlements, it is important for family lawyers to have a basic understanding of corporate law issues in order to provide advice during the stages of the settlement negotiations.

2. TYPES OF BUSINESS INTERESTS

If a client advises that he or she (or his or her partner) has an interest in a business, the first step is to determine the type of business interest held. This should be determined at the beginning of the file, as the type of business interest can significantly affect the options available for structuring the settlement between the clients.

A. Sole Proprietorships

A "sole proprietorship" is a business that is personally owned and operated by an individual (i.e. a sole proprietor). A sole proprietorship is not a separate legal entity and the business operations are carried out by the individual at the personal level. Although the individual may maintain separate financial statements for the business, the assets and liabilities of the business, along with all its revenues and expenses, are personally attributable to the individual.

For the purposes of structuring a family law settlement, the sole proprietorship is considered a personal asset/liability and the income/expenses are accounted for personally.

B. Partnerships

A "partnership" is a business relationship between two or more individuals or entities carrying on a business in common with a view to profit¹. An individual's interest in a partnership is determined in

¹ *Partnership Act*, RSA 2000, c P-3, sub. 1(g)

accordance with the terms of the partnership agreement. Although an individual's share in the assets of the business is typically equal to that individual's share in the liabilities of the partnership, the individual's proportionate share in the assets and liabilities of the partnership can differ.

Accordingly, it is important to review the partnership agreement in order to determine the particular interests of the clients.

Similar to shares of corporations, partnership interests can only be transferred in accordance with the terms of the partnership agreement. Therefore, if the clients are engaged in a partnership with a third party, the clients' options for the purposes of structuring a family law settlement may be limited.

C. Corporations

A "corporation" is a separate legal entity that exists independent of its directors and shareholders. As a separate legal entity, the corporation is treated as its own person², with its own assets and liabilities.

An individual's interests in a corporation are limited to his or her interests as a shareholder. While shareholders often treat corporations as being an extension of themselves, shareholders do not have any direct ownership interest in the assets of the corporation (nor are they liable for any of its liabilities). It is important for clients to understand that the corporation is a separate legal entity and that it is not a party to the separation. Most notably, the assets of the corporation cannot be leveraged by the clients for the purposes of settling the division of property without undergoing extensive corporate and tax planning to extract the assets from the corporation to the clients personally.

3. GATHERING INFORMATION

The information required by lawyers and accountants to assess an individual's business interests depends on the type of business and the particular interests of the individual. As a starting point, the following information pertaining to business interests should be requested from both the client and the client's partner:

- Sole proprietorships – business financial statements and personal tax returns (CRA Form T1);
- Partnerships – partnership financial statements, partnership information return (CRA Form T5013), and personal tax returns (CRA Form T1); and

² *Salomon v. Salomon & Co. Ltd.*, [1897] A.C. 22

- Corporations – minute book, corporate financial statements, corporate tax returns (CRA Form T2), and personal tax returns (CRA Form T1).

Generally, the information for sole proprietorships and partnerships can be obtained from personal documents. However, only some of the information with respect to an individual's interests in a corporation can be obtained from personal documents, so access to corporate records is often required. Directors are entitled to access the following corporate records³:

- Articles, Bylaws, and Unanimous Shareholders' Agreements;
- Minutes and Resolutions of Directors;
- Minutes and Resolutions of Shareholders;
- Notices to Corporate Registry re: Directors;
- Share Registers;
- Financial Statements; and
- Director Disclosures re: Contracts to which Directors are a party.

Shareholders are entitled to access all of the above corporate records, except for the Minutes and Resolutions of Directors⁴, which are available only to the directors.

Any person, including a partner who has no interest in the corporation, can obtain access to the shareholder register⁵.

Where the clients are directors and shareholders of the corporation and no third parties are involved, disclosure is typically not an issue because they have full rights to access the information and there are no confidentiality concerns. However, where only one party is interested in the corporation and there are third parties involved, disclosure can be problematic, as the interested party may not have access to the information or he or she may be unable to share information with the uninterested party. Since the corporation and third parties are not parties to the separation, courts are hesitant to order disclosure beyond what is required under the legislation. Therefore, in such cases, the clients may need to rely on the information available personally.

³ *Business Corporations Act*, RSA 2000, c B-9, sub. 23(1) [BCA]

⁴ BCA, sub. 23(1)

⁵ BCA, sub. 23(4)