STARTING A BUSINESS IN **BRITISH COLUMBIA**

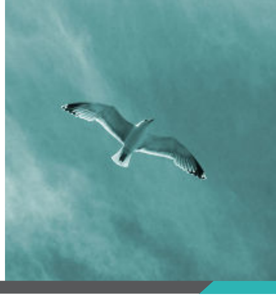
INTRODUCTION

You have an idea for a business you are passionate about. You have evaluated your idea and you know it is feasible and that it will flourish. You have done your market research and understand the industry and the competition. You have your business plan in hand. What now?

Building Your Team/What Help Do You Need

At this point you want to retain the professional advisors for your business. These are the people who will help you decide the structure of your business, help you set up that structure and ensure your business conforms with all legal and regulatory requirements imposed upon it. Almost all businesses will need a lawyer, an accountant and a banker. You may need more specialized help but the right lawyer and accountant will be able to help you locate any specialists you need.

Your lawyer and accountant can advise you about the business structure you will want to use, help you with the structure of the financing for the business and assist you with applying for the necessary permits and licences required for your business. Your accountant will be able to help you with setting up the accounts for the business so that you can properly track your business activities and report to your stakeholders and the government. Your lawyer will be able to help you establish the business structure you chose and advise you about and draft the different contracts and agreements your business requires. Your banker will help you establish the necessary bank accounts you need to carry on your business and may be a source of financing.



NECESSARY FIRST STEPS

By putting together a business plan you will have a good idea of how your business is going to operate. What you may not have considered are some legal and regulatory requirements that go along with starting a business. Depending on the nature of your business, you may need to obtain a number of different licences, permits and registrations in order to operate. You should also be aware of the tax and employment issues that relate to starting a business, as well as any additional considerations specific to the services or products you will be providing.

Licences and Registrations

Operating a business means you must comply with various registration and licensing requirements imposed by different public bodies. For starters, municipalities in BC require that businesses apply for a business license in order to operate within their boundaries. The cost and type of license will vary from one municipality to another and will depend on the nature of your business. You may have to apply for licenses in multiple areas depending on the nature of your business and where you plan to operate. Certain types of businesses may qualify for a mobile business license, which is a license that allows mobile businesses to operate across participating jurisdictions and can help save time and money.

There may be additional licensing or permit requirements beyond a business license depending on where your business is located and the types of activities your business will be engaged in. For example, resource sector businesses often require additional licensing due to the environmentally sensitive nature of their operations, and restaurants will require licences and permits to serve food or alcohol. The BC Government website is a good starting point to help you determine what licences and permits you will need to operate your business. Particularly when starting out, you should also consult with your advisory team to ensure your business is compliant with all licensing requirements.

Tax Matters

Tax has an impact on most aspects of your business and should be discussed with your advisors early on. Considerations will vary depending on the type of structure you use to operate your business, where you are operating and the services you are providing.

If you are operating your business through a corporation, you will have been issued a business number on incorporation, but if the business operates as a proprietorship or partnership you will need to apply and be registered with Canada Revenue Agency in order to obtain a business number. A business number is a unique number assigned to your business that is used to identify your business when communicating with Provincial and Federal Government agencies, including for tax matters.

If you sell or lease goods or services that attract Provincial Sales Tax (PST) you will need to register to collect such tax and remit it to the British Columbia Ministry of Finance. The same applies to registering with the Canada Revenue Agency to collect and remit Goods and Services Tax (GST) if you sell or provide services in Canada and your world-wide sales total more than $30,000 in a given year.

Your business may have additional tax requirements depending on its nature and operations. Your advisors can advise you about what requirements will apply to your business.

Employment Matters

Most businesses have workers. As your new business hires workers there are additional steps you need to take to comply with the rules governing workers in British Columbia. Before you begin hiring, consider what type of working arrangement your business will need and whether your work force will consist of employees, contractors or a mix of both. These choices will depend on the nature of your business, industry norms, expectations of workers and how you choose to structure your business. Generally, employers will have a greater degree of responsibility toward employees than contractors.

If you hire workers as employees, the BC Employment Standards Act will impose certain minimum requirements on you as an employer, concerning things such as wages, vacation pay and hours of work. Failure to meet these standards can result in penalties and claims by your employees. You must have adequate record keeping systems in place before employees start work to track things such as wages, benefits, hours worked, vacation time taken and amounts paid to employees.

Almost all employers will need to register their business with WorkSafeBC and pay premiums to obtain coverage protecting their employees in the case of work-related injuries or diseases. WorkSafeBC, besides being the provincial workers-compensation insurer, also regulates and enforces workplace safety. Contact your advisory team to confirm whether your business is one of the few exempt from registering with WorkSafeBC.

Lastly, as an employer you will be legally required to make payroll deductions from employees for Canada Pension Plan contributions, employment insurance premiums and income tax. These amounts must be remitted and reported on to the Canada Revenue Agency. These deductions are legally required for all employees but there may be additional deductions you agree to with your employees for things such as pensions, RRSP contributions, health benefits or additional insurance. Depending on the type of employees you seek to engage, you may consider these benefits as additional forms of compensation. You will want to take special care to ensure all of these deductions are made and properly remitted as there is personal liability on corporate directors and officers for the failure to remit many payroll deductions.

Other Considerations Specific to your Business

There may be other factors specific to your business you should consider when starting out.

If your business depends on a valuable piece of intellectual property – such as a specific product design or a highly identifiable logo – you should consider taking additional protective steps, such as filing for patent or trademark registration.

If your business has customers or operations in jurisdictions outside of British Columbia, you may have additional compliance obligations to consider.

If your business operates in a particular industry there may be additional legal concerns. Industries that raise environmental concerns, impact First Nations' interests, interact directly with individual consumers or deal with food or drugs are a few of the many industries that will raise their own unique set of issues.

Your team of advisors is a good first stop for issues such as these and can help you identify where you may need to take additional steps or seek additional help to ensure your business is compliant and protected.

BUSINESS STRUCTURE

Having the correct legal form for your business is important – it can dictate how you can raise capital, how your business profits are taxed and what type of personal liability you will have for obligations of the business. The three most commonly used forms are: sole proprietorships, partnerships and corporations.

Many businesses start out as sole proprietorships or basic partnerships because of their simplicity and, once they have proven to be successful, transition into another business form such as a corporation. While this approach can save some money up front, reorganizing a mature business will be more complicated and expensive than getting the structure right from the outset. It is worth sitting down with your legal advisor early on to decide what structure will be best for your business.

Sole Proprietorships

Sole proprietorships are the simplest business form. In a sole proprietorship, the business is not distinct from the owner. This means that if you run your business as a sole proprietorship, you supply all of its capital and all of the business's profits – and losses – are borne by you personally.

The principal advantage of a sole proprietorship is its simplicity. Other than registering a name with the BC Registry, no paperwork or out of pocket expenses are required to create a sole proprietorship. You might also consider using a sole proprietorship if you have sources of income coming from outside of the business and you expect the business will incur losses. Because the sole proprietorship is not its own legal entity, you may be able to offset your business losses against your other income and reduce the amount of income tax you owe. This may be the case if you are "moonlighting" and running your start-up business in the evenings after you get home from your day job.

The main disadvantage of a sole proprietorship is that it does not offer any protection from personal liability. If your business owes money, you owe that money personally as well. This means, for example, that your non-business assets (like your car and home) could be available to your landlord if your business cannot make its lease payments. The risk of personal liability is one of the driving forces behind most business owners' decision to incorporate. In addition, once your business becomes profitable, a sole proprietorship may not give you the most favourable tax treatment because you will be taxed personally on all of the business's income rather than being able to take advantage of favourable corporate income tax rates.

One thing to keep in mind when starting out is that by registering a name with the BC Registry you are able to operate your business using that name, but the registration process does not provide you with much protection from others who may seek to operate using a name that is the same as or similar to yours. Incorporating a company using your businesses name will offer more protection, but if you believe your business' name is critical for your success you will want to speak with your advisors about registering a trademark.

Partnerships

Partnerships – as the name implies – are businesses owned and run by two or more people, or partners. Partnerships have many of the same advantages and disadvantages as sole proprietorships. Like sole proprietorships, they can be very simple to create with little paperwork required (although in many cases partners will want to govern all aspects of their relationship with a detailed and complex partnership agreement). However, like sole proprietorships, they do not shield owners from personal liability. Each partner of a general partnership is personally liable for all of the obligations of the business. Partnership liability can bring with it even more risk than sole proprietorship liability because each partner can be personally liable for the actions of each other partner, even if they were unaware of those actions. What this means is that your personal assets could be at risk if one of your partners is making unprofitable deals on behalf of the business without your knowledge or permission.

Corporations

Corporations are generally the preferred legal form for most businesses. Unlike a sole proprietorship or a partnership, a corporation is – at least in the eyes of the law – legally distinct from its owners. This is a huge advantage because it can, subject to some exceptions, allow you to isolate the liabilities of the business in the corporation and away from your personal assets. A corporation's creditors have no recourse to the corporation's shareholders or their assets, absent exceptional legal circumstances or where the shareholders have agreed to guarantee the corporation's obligations.

Corporations can also make raising capital easier. It can be difficult to structure outside investments into a sole proprietorship or partnership. Corporations, on the other hand, allow you to issue shares to investors seeking an equity stake in the business. Shares are familiar to investors and can be easily transferred in the future. They can also be tailored to give specific rights to certain classes of people. For instance, your shares as founder might give you voting control over major business decisions, while shares issued to a passive investor might give fewer (or no) voting rights but pay a dividend at a preferred rate.

Corporations can also be advantageous for tax purposes. Corporate profits are taxed at a lower rate than most individuals. While you will still need to pay tax on any salary and most dividends that you eventually draw from your corporation, any profits that you leave in the corporation can benefit from this lower rate, allowing you to fund your business' continued growth.

The downside of using corporations is that they take some work to set up and maintain. For the smallest of businesses, sometimes this extra cost and effort isn't worth it. However, the process is relatively straightforward and, for most businesses, will be worth the extra protection that incorporating provides. EKB offers a fixed price incorporation package for start-up businesses to help take away some of the uncertainty around incorporation costs.

Other Business Forms

In addition to sole proprietorships, partnerships and corporations, certain other specialized business forms are available to business owners. These forms include limited partnerships, limited liability partnerships and unlimited liability corporations. Your legal advisors will be able to discuss these with you to determine whether any are appropriate for your business.

When starting a new business one of the first things you are likely to do is be out looking for somewhere to operate. Unless you are going to operate your business from your home, that likely means you are going to be leasing space.

Note that a business lease is different than a residential lease. When renting a home there are protections for tenants in the Residential Tenancy Act as well as the ability to have disputes dealt with under the Act by a government employee. These protections are largely lacking for commercial leases. Most residential leases are for a set amount of rent plus some specified expenses, such as utilities. Most commercial leases are referred to as "triple net" leases. A triple net lease means that the base rent does not include any of the expenses incurred in operating the property, so the tenant is charged for its share of things such as property taxes, insurance, utilities and maintenance. This can include charges for common areas, such as hallways, entrances, parking lots, sidewalks and the like, as well as a charge to cover the costs of the landlord in managing and administering the property.

Negotiating a Lease

Assuming this is your first time negotiating a commercial lease you might want to seek the assistance of a commercial real estate agent, a lease consultant or your lawyer to help you through the process. Whether you seek assistance or not, before you start looking you will want to think about a few things to help narrow your search, such as:

How much space do I need? — When picking a location you should consider when and if you will need more space to expand your operations.

What amount can I afford to pay? — Remember that you will likely be paying a base rent plus triple net charges, so you need to ask not just what the base rent is but what the triple net charges are expected to be. Triple net charges will vary as the inputs vary and they rarely go down. Landlords may also want to charge a percentage rent, meaning that they expect to be paid a percentage of your revenue.

What is my ideal location and what other locations will work? — Think about where in the city you want your business to be located but also take into account other factors such as the type of zoning area you want to be in, the ease of parking and your proximity to transit, shipping and competitors.

Before you start looking for space, think about what you want in a lease and then divide those into "must haves" – the non-negotiable items – and the things you would like to have but that are not deal breakers. Write these down and refer back to them from time to time. Some of the things you might consider are:

The ability to transfer your lease to a company — If you are in the process of incorporating a company to carry on your business or think that you might do so down the road, you will need the right to transfer your lease to your company.

The right to assign the lease or sublet — A right to assign or sublet your lease will allow you to transfer the lease along with the business if you decide to sell your business. It also allows you to assign or sublet the lease if the business is not as successful as you planned.

Inducements — Think about benefits your landlord can offer to get you into the lease. These could include rent free periods or cash allowances from the landlord for you to improve the space, stock your premises and/or build traffic for your business.

Signage — Consider whether location or size of signage is important for your business.

Parking — Consider whether the operation of your business will require employees, suppliers or customers to be able to park at your premises.

Exclusive rights to carry on your business — An exclusive right to carry on your business will be especially important in malls or other areas where your business may be at risk of being in close proximity to competitors.

Options to renew — While you will want only to commit to lease a term of a certain length, it can be important to have the flexibility to lease for a longer period.

Landlords will try to introduce certain terms that you should be cautious about accepting. Some of these terms are:

Percentage rent — If the landlord is to be paid a percentage rent you will need to disclose your revenue to your landlord and either have those numbers confirmed by an auditor or agree that the numbers and calculations you provide will be subject to audit. Percentage rent not only increases the amount of rent payable but may result in your having to pay auditing expenses, and means you will be sharing information with your landlord you would likely wish to keep confidential.

Restrictions on additional businesses — The landlord may seek to limit your right to open further businesses within a prescribed radius of the property you are leasing.

Demolition clauses — The landlord may seek to include clauses that give it the right to terminate the lease on limited notice if the landlord wishes to redevelop the land and premises.

Relocation clauses — The landlord may try to include a clause that allows it to move your business to another location in certain circumstances.

Offer to Lease

The process of entering into a commercial lease can vary but usually it starts with some verbal negotiations to see if the landlord and tenant have some common ground. The next step is usually entering into a relatively short written document. These can be called any number of things – offer to lease and letter of intent are the terms we often see. They are most often prepared by the landlord or his or her representative. Note these are often binding agreements and can create onerous obligations. They should not be signed without careful review and an understanding of their effect.

An offer to lease should address the following elements of the lease:

Description of Premises — The offer should provide a description of the premises in sufficient detail to be able to clearly identify the premises to be leased along with the area of the premises. Often a diagram of the premises is attached showing the premises in relation to the surrounding space.

Term — The offer should set out the initial term of lease along with any options to renew.

Use — The offer should describe the permitted use of premises and any restrictions.

Rent and Costs — The rent expressed either as a square foot rent or rent per month should be set out in the offer along with a description of additional costs payable by the tenant, including common area charges, and the method of calculating the rent for any option periods. Percentage rents and other costs should also be addressed.

Inducements — The offer should set out any allowance for leasehold improvements, incentive for renting and other payments or inducements to be made by the landlord.

Possession — The date of delivery of the premises should be in the offer as well as the conditions of premises on delivery, and any rent free periods for installing fixtures or stocking the premises.

Insurance — The offer should state the insurance responsibilities of the landlord and the tenant.

Form of Lease — Often the landlord's form of lease is attached to an offer and there is an agreement to enter into the form of lease with such necessary changes to reflect the agreements in the offer to lease.

Non-binding — If the offer to lease is expressed to be a letter of intent, a statement that the document is non-binding is necessary.

Similar to real estate agents who act for buyers and sellers of residential property, there are real estate agents who specialize in leasing of commercial premises. The landlord may have engaged such a real estate agent to market the premises to prospective tenants and to advise the landlord in the negotiation of the offer to lease. In some cases a tenant will have retained their own realtor to assist them in finding suitable premises and negotiating the offer to lease.

The offer to lease should address who will be responsible for payment of real estate commission. Generally the Landlord will be responsible for payment of commission both to its real estate agent and the agent retained by the tenant.

As stated above, the offer to lease, unless it provides otherwise, will create a binding obligation of the tenant to lease the premises and pay rent for the lease term. This is the time to negotiate with your landlord: to make your "asks", to bring up your "must haves" and your "nice to haves". This is also the time to walk away if you cannot get what you need.

As the offer to lease will likely be binding, you should consider including subject condition clauses that address any matters which you will need to determine and settle before committing yourself to the lease. An important example is review and approval by the tenant (and its lawyer) of the landlord's form of lease. A further example is advance landlord approval of any improvements to the premises which the tenant wishes to make. The landlord may also wish to include subject condition clauses for its benefit, such as the landlord reviewing and being satisfied with the tenant's financial statements.

The Lease Agreement

After you have a signed offer to lease, the landlord will prepare a form of lease for execution. The lease may take many forms but most cover the same ground and are generally written in favour of the landlord. The Lease will usually contain the following clauses:

Parties and Premises — The basic identification of the parties (landlord, tenant, guarantors), the premises, the building in which the premises are located and the square footage. Often there will be drawings or plans attached to the lease to more particularly describe the premises.

Rent — Rents, additional rents and charges, incentives and rent free periods, including common area definitions and charges, charges for taxes, utilities, insurance and security deposits.

Term — The term of the lease with commencement and end dates.

Use — Permitted uses of the premises along with any restrictions.

Common Areas — Parking and use of common areas.

Renewal — Any options to renew the lease and when those options must be exercised.

Maintenance — Repair and maintenance obligations of the tenant and the landlord.

Compliance — Obligations on the tenant to comply with all applicable laws.

Signage — Requirements about any signage permitted on the property.

Assignment — Whether the tenant has any right to assign the lease or sublet.

Insurance — The terms of the insurance which the tenant is required to obtain.

Default — The landlord's rights of entry for inspection and on default under the lease.

Indemnification — Obligations on the tenant to indemnify the landlord.

Destruction — Rights of landlord and tenant on complete and partial destruction of the property, which may include rights to terminate all or part of the lease.

Default — Events considered to be a default under the lease and the rights and remedies available to the landlord on default.

Notice — Notice provisions for the landlord and tenant under the lease.

Registration — Rights of the tenant to register the lease.

Mortgage — Rights of the tenant to mortgage the lease.

Leases are long and ponderous documents that take a long time to read. It is preferable to have a lawyer review and explain the lease to you, but often cost is an issue and often the landlord is not prepared to negotiate the lease. In any event, you should read and understand the lease before signing. If there are provisions you do not understand, ask the landlord to explain the provisions and if the explanation does not match up with the language of the lease ask that the lease be changed to match the explanation.

Registering Leases

Leases are an interest in land and can be registered in the Land Title Office. Your lease must be registered if you want to get the best protection from the landlord's creditors and ensure that anyone who purchases and leases space from the landlord does so subject to your lease. There is a cost for registering a lease and there may be additional required costs for surveys or subdivision of the landlord's property. Many landlords, particularly if the premises are in a mall or office building, will state that you are not entitled to register your lease. The probability of anything negative occurring is likely very small but you should judge the cost of compliance against the probability and the cost of losing the lease.

SHAREHOLDERS' AGREEMENTS

If two or more owners decide to operate a new business through a corporation, they should consider entering into a shareholders' agreement to set out the general business agreement between themselves as shareholders of the corporation.

Corporate law and a corporation's statutory constituent documents (in B.C. those are called the Notice of Articles and Articles) provide a general framework for how a corporation is governed and managed. However, these documents will not address all issues that may be relevant to shareholders so in many cases it is helpful to enter into a shareholders' agreement to supplement this framework with additional rules covering gaps not expressly covered by law or the constituent documents. An effective shareholders' agreement can ensure shareholders' respective roles and interests in the corporation are clearly set out, allowing the corporation to be managed as the shareholders intended and for the benefits and obligations of the business to be shared appropriately.

Shareholders' agreements can be used to:

- set out how the affairs of a corporation will be managed;
- set out what rights the shareholders have to share in the proceeds of the corporation;
- establish the respective contributions made by shareholders to the corporation and any obligations to make future contributions;
- provide ways to resolve potential conflicts between shareholders; and
- provide protection for minority shareholders.

We recommend that shareholders enter into a shareholders' agreement in the early stages of starting a business. If the shareholders establish their respective rights early on, it can allow a business to operate smoothly and for disagreements to be dealt with as prescribed in the agreement. If shareholders wait until there is a conflict, deadlock or disagreement before trying to come to an agreement on their rights and obligations, it is usually too late.

There is no one size fits all shareholders' agreement. To be effective, shareholders' agreements need to be tailored to address the specific needs of the business and the interests and concerns of the shareholders. However, there are some provisions often found in such agreements, including:

Officers and Directors — Shareholders' agreements can dictate the make-up of the board of directors as well as who will hold certain officer positions. In closely-held corporations with a few shareholders who hold an equal number of shares, often each shareholder will be entitled to elect themselves or a representative on the board of directors.

Matters Requiring Unanimous Approval of Directors — While the day-to-day operations of the corporation may be delegated to a single person or a small group of people, shareholders' agreements often stipulate that certain actions, such as issuing dividends or additional shares in the corporation, will require the unanimous approval of the directors of the corporation.

Right of First Refusal/Pre-Emptive Rights — Shareholders' agreements can include provisions giving existing shareholders the right to buy any shares that are proposed to be sold by an existing shareholder or the right to participate in any new issuance of shares by the company (pre-emptive rights). This type of clause allows existing shareholders to prevent dilution of their ownership interests and to control who may have an ownership interest in the corporation, or put another way, who may be their business partner.

Drag-Along/Tag-Along Rights — Shareholders' agreements often include provisions which assist in circumstances of a third party wishing to purchase the business by way of buying the shares in the corporation that owns the business. Drag-along rights (sometimes referred to as draw-along rights) can allow shareholders who have agreed to sell their shares to a third party to compel the other shareholders to sell as well (or be "dragged along" into the deal). Tag-along rights (sometimes referred to as piggy-back rights), on the other hand, allow minority shareholders to require that before another shareholder accept a third party's offer to buy its shares in the corporation, the minority shareholders must also be included in the deal on the same conditions (or be able to "tag along" into the deal).

Death of a Shareholder — Shareholders' agreements often state that the surviving shareholders must purchase the shares of a shareholder who dies or become permanently incapacitated. This type of provision prevents shares from passing to a beneficiary of a deceased shareholder who the other shareholders may not want to be a business partner. Often, it can be difficult for the other shareholders to come up with an immediate lump sum of cash to purchase the deceased shareholder's shares. Corporations will often buy insurance policies for its shareholders to assist in financing such a buy-out.

Shotgun Clauses — Shotgun clauses can be useful in settling irreconcilable differences between shareholders. Shotgun clauses allow shareholders to trigger a process where a price is set and the other shareholders of the corporation must either agree to buy-out the triggering shareholder at that price, or agree to sell all of their shares to the triggering shareholder at that price. This clause is a relatively severe method of resolving disputes between shareholders and can be problematic where shareholders have disparate financial resources. Where parties do not have an imbalance of financial resources, however, it can be one of the more efficient and cost-effective ways for shareholders to break a deadlock between shareholders.

The above examples are not the only matters that can be included in a shareholders' agreement and each of them is not necessarily present in every agreement. Most private corporations will want to have some form of shareholders' agreement in place and such agreements can be individually tailored to address the corporation's needs. Your lawyers can assist you in preparing an agreement that corresponds to your business and management model.

FINANCING

Few businesses get very far without some source of financing. Whether used for purchasing equipment, entering into a lease for your business premises or simply purchasing additional inventory so that you can fill orders, at some point early on in your business' lifecycle you will likely need cash over and above what your business is able to generate. At the very earliest stages, this financing will likely come directly from you and perhaps a few close friends and family. As your business proves to be more successful, your financing options will broaden – you may be able to attract outside investors who view your business as an investment opportunity or your business may be able to borrow money on its own credit.

This article assumes your business is operating as a corporation. Businesses that operate as partnerships or sole proprietorships generally have a more difficult time attracting third-party investments, outside of loans that the sole proprietor or partners are personally liable for. See EKB's article on the topic to learn more about the benefits of using a corporation versus operating as a sole proprietorship.

Equity vs Debt

The two most common ways corporations raise capital are issuing equity (e.g. shares) and incurring debt (e.g. borrowing money through a bank loan). Generally, debt investors are looking for lower, safer returns and regular interest payments, while equity investors are willing to accept more risk for higher returns and the possibility of waiting for a long time before their investment pays out. In the event a corporation winds up its business or dissolves, debt investors must be paid out in full before equity investors receive a penny – this preferential return of capital is why debt is considered safer than equity and why equity generally commands higher returns.

Debt can be either "secured" or "unsecured". Debt that is secured has priority over unsecured debt to the extent of the assets used to secure the debt. Think of secured debt like a mortgage over your property – if you default on your mortgage, your bank can foreclose on your property in order to satisfy its debt and does not need to share any collections with your unsecured bill collectors.

Equity can take many forms. The most common form – the aptly named "common share" – typically grants shareholders rights to receive dividends, participate in the residual value of the business if it liquidates or winds up and vote on major corporate issues such as choosing the corporation's directors or whether or not to sell the business. Other common types of equity include non-voting shares, which give a holder the economic benefit of owning shares in the corporation but do not allow holders to participate in corporate decision making, and preferred shares, which can pay dividends and receive distributions in the event the corporation dissolves or winds up ahead of (or "in preference" to) common shareholders.

Founder Financing

You will probably be your own first source of financing when your business is starting up. Founders generally invest through a combination of shares and loans to the business. Usually the shares are purchased from the corporation for a relatively nominal amount and the bulk of the actual cash used to fund the business is treated as a loan from the founder to the corporation. This is advantageous for two reasons: (1) loans can typically be repaid tax free with little to no corporate action, while returning equity capital requires legal paperwork and potentially incurs taxes and (2) loans will have a better claim against the assets of the corporation in the event it is dissolved or winds up. As a way of further protecting your investment, your founder's loan can be secured by the assets of the business in order to give priority over your business's other creditors.

Outside Investor Financing

Opening your business to outside investors can be an exciting opportunity – you have found people (even if they are your close friends and family) who believe in you and your business and are willing to contribute to its success. It can also be a challenging time as investors will likely want to earn a reasonable rate of return on their investment and will want to be as protected as possible against loss. You, on the other hand, will want to be cautious about giving up too much control over your business, diluting your share of the business's future appreciation or incurring any onerous interest obligations that will crimp your business's ability to grow.

Equity Financing

Selling shares is a common way to structure outside investment in your business. Share investments are attractive to both investors and owners – they allow your investors to participate in the value growth of the business without impacting your immediate cash flow by requiring regular interest payments. There are, however, a few pitfalls that you will want to be on the lookout for when issuing shares:

- If you are issuing voting shares, you will want to consider how your ability to control the corporation will be impacted. Often, a share issuance will necessitate a shareholders' agreement to govern control of the corporation among shareholders and other key issues. Another option is to issue shares with fewer voting rights than the founder's shares (or no voting rights at all).
- You will want to be sure that the issuance is done in compliance with securities law. Broadly, securities law governs all distributions and trades in "securities" (which include shares, bonds and other types of investments). Any issuance of shares – a security – to an investor must be done pursuant to a prospectus or pursuant to an exemption from the prospectus requirement. A prospectus is a comprehensive and expensive to prepare disclosure document that describes your business's financial position and relative risks that is given to investors before they decide whether to invest in your business. Failure to comply with the prospectus requirement or to find an applicable exemption can have serious regulatory consequences and can result in liability to shareholders who purchased improperly issued shares. Luckily, most share issuances by closely held businesses will qualify for a prospectus exemption. Your legal advisor will be able to advise you on how to properly structure a share invest-ment to ensure securities law compliance.
- To take advantage of preferential tax rates available to small businesses, your corporation will need to maintain its "Canadian-controlled private corporation" status. This means, among other things, that your corporation cannot have over 50% of its shares

owned by either public corporations or non-Canadian residents. In addition, maintaining your business's "CCPC" status is one of the requirements to take advantage of the exemption from capital gains tax if you eventually end up selling your shares. Accordingly, you should consult your legal advisor before considering any share issuances to non-residents or publicly owned companies.

Debt Financing

Third party debt financing can be a powerful tool for a business owner. It can allow you to expand your business and increase your returns on investment without diluting your ownership position. It is also a potentially dangerous tool in that if your business is carrying too much debt, or is "over-leveraged", it may have to divert all of its cash to making interest payments, or, in the worst case scenario, default on its loans and be forced into bankruptcy. You will want to evaluate your capital structure periodically with your advisors to ensure that you have the right mix of debt and equity to allow your business to grow and to provide satisfactory returns on equity.

The most common source of debt financing is a bank, but other types of lenders exist. Your particular lender, your business profile and the intended use of the cash will determine the structure of the debt financing available to you, which could include one or more of the following:

Revolving Line of Credit — This is a loan facility that is typically used to smooth out day-to-day operating expenses of your business. It can be borrowed against more than once. As you repay your line of credit, its availability refreshes and is available to be borrowed against once again. You pay interest only on the amount drawn. Typically lines of credit are secured, either by your business's "current assets" – its accounts receivable and inventory or by all of your business's assets.

Term Loan — Term loans are longer dated loans that are typically drawn on once in a lump sum and repayable all at once on the maturity date (potentially with scheduled principal payments during the life of the loan). They are often used to fund large, one-time costs, such as the purchase of an expensive piece of equipment or piece of property or the acquisition of a competitor's business. They are typically secured either by all assets of the corporation or by the particular asset being acquired.

Finance Leasing — Sometimes it is possible to structure a debt financing as a lease, where the financing source actually owns the asset and leases it to you for your business's use. This can be advantageous because it can in some cases allow you to write off the lease payments against your income for tax purposes.

Trade Credit — Receiving credit terms from your suppliers, where you take a delivery of goods and pay for them in the future, is a type of debt financing. This can be a method of letting your suppliers partially fund your growth. Unless you have very fast inventory turnover, it can be difficult to fund growth purely through trade credit. In addition, many suppliers offer incentives for prompt payment that you will be missing out on by delaying payment.

Debt investors, particularly banks, lending to small businesses just starting out, will often want owners to personally guarantee their business loans. This can have the effect of removing the liability shield that conducting your business through a corporation offers. You should carefully consider with your legal advisors the effects any guarantees could have, although, in some cases, the lender will have the superior negotiating position and you will have no choice but to acquiesce to the guarantee in order to obtain financing.

Professional Assistance

Financing transactions can raise complex legal, accounting and financial questions. Many business owners who are used to operating their corporations and not raising capital for a living will not be well versed in dealing with these types of issues. It is always a good idea to talk with your professional advisors at the outset of any financing transaction to make sure you are raising money in the most efficient manner possible and in a way that complies with all applicable laws.

ekb.com