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Starting a Small Business

Starting a new business is a very exhilarating time for a new business owner. The ship is now under your command and you are responsible for the voyage forward. However, almost instantly, it seems the business Gods are determined to humble you and mockingly reveal some of the flaws in your well thought out business plan. Lesson number one, usually learned on day one or two, it never goes according to plan.

It is a rewarding experience for us to help our clients launch their business idea and to guide their ship toward profitable ports and away from the kraken, hydra and other distressing business nemesis. Set out below are a few things to consider before taking the plunge and launching your new business:

1. **Hail to the Accountant.** As a lawyer, this is a difficult one to admit and it bruises the legal ego a tad. Your most important professional advisor will likely be your accountant or tax advisor. Taxes rule the commercial universe and having an advisor who can provide you with sound tax advice and structuring advice is critical. Bottom line, find a good accountant, someone who you have a high level of trust and someone who can explain tax issues to you in a language that you understand.

2. **Incorporation.** The question as to whether to incorporate is driven mainly by the tax advantages of operating as a company (such as the small business tax rate and income splitting) compared to operating as a partnership or proprietorship. The other main advantages to incorporating are: (1) the professional image it projects of your business; (2) the liability shield it provides to the shareholders from claims by creditors (but typically not the company's lender, as your lender will require personal guarantees from the shareholders); (3) a company can exist forever whereas individuals do not; and (4) a company can provide a level of anonymity to its owners.

   On the other side of the ledger, some of the disadvantages to incorporating a company are: (1) the startup costs are around $1,500; (2) added administrative work, such as annual tax filings, filings with the Registrar of Companies in Victoria, and passing of annual corporate resolutions; (3) less tax flexibility than a partnership; and (4) increased work when you decide to end the business.

3. **Signing Contracts.** Even before the business is launched, you will be signing a slew of new contracts: possibly a lease of real property, equipment leases, bank account documents, credit card applications, employment contracts, computer software licences, etc. Often new owners sign these contracts in their personal name before their new company is incorporated. If you sign contracts in your personal

name, rather than in the company's name, be aware that: (1) you are personally liable under the contract you signed (which means you will not receive the benefit of the liability shield had your company signed the contract); (2) the company has no legal right to enforce the contract as it is not a party to the contract; and (3) there may be administrative costs to assign the contract from you personally to the company or, even worse, the other contractual party may refuse to approve the assignment of the contract from you personally to the company (this often happens with leases of real property).

4. **Working Capital.** It is important to plan and budget for the costs it will take to startup your business and how long it will take to generate and (most importantly) collect revenue. Whatever you budget to startup the business, it will likely cost more. The big five banks will typically provide relatively nominal unsecured capital to start up a new business (under $75,000). There are other potential sources of capital to consider if larger amounts of startup working capital are required, such as the Business Development Bank of Canada (see https://www.bdc.ca/en/pages/home.aspx).

5. **Shareholder's Agreement.** If you will be incorporating a company and the company will have other shareholders (your business partners), then it will be important to set out in a shareholder's agreement: (1) what are the voting rights of each shareholder and how directors are appointed; (2) what decisions require unanimous approval of the shareholders or directors of the company (such as sale of the business, admitting a new shareholder to the company or a major business expenditure); (3) if there is a falling out between the shareholders, what is the exit plan for a shareholder and/or how do shareholders buy other shareholders out; (4) if the company requires more working capital to operate, do shareholders have an obligation to contribute more personal funds to the company; and (5) if a shareholder passes away or divorces, what happens to their shares in the company.

   A partnership with multiple partners must consider many of the same issues and should address those issues in a written partnership agreement.

6. **Life Insurance for Key Shareholders.** If you will have multiple shareholders in your company, it is prudent for the company to obtain life insurance for critical individual shareholders so that if a critical shareholder were to unexpectedly pass away, the company would have access to sufficient funds to buy out that late shareholder's interest. If the loss of a shareholder would also have significant impact on the company's day-to-day cash flow, additional life insurance should be considered with the business as the designated beneficiary so that the business will have extra working capital to work through the unexpected loss of a key revenue contributor in the short term. The same issues apply to a partnership.

7. **Business Insurance and Limitation of Liability.** It is important to consult with your insurance advisor to determine what type of insurance would be prudent and common for the type of business you intend to operate. Mistakes happen to even the most careful of people, so it is highly risky to operate without insurance. This is especially the case if you will be operating as a partnership or proprietorship where you are personally liable for the negligence of the business.

Also, consider adding waivers or limitations of liability in the standard purchase orders, contracts or engagement letters you prepare for your business and use with your customers. For example, consider limiting the damages a customer can claim against the business to the amount the business billed the customer for the services performed or to a maximum dollar figure. Avoid leaving the potential liability as an unlimited amount, if possible.

8. **Organization of Personal Finances.** If you are leaving a secure position of employment or source of income before you launch your new business, you should consider locking in your residential home mortgage for a sufficient period of time so that when it comes up for renewal you will (hopefully) have a track record of respectable earnings from your new business. Having your mortgage come up for renewal in the first or second year of operations at your new business is not ideal. In addition, consider making an application to your bank to increase your mortgage, obtain a home equity line of credit or an unsecured line of credit before you start your business. This will provide an extra safety line of working capital, should it be needed. You are far more likely to receive additional credit from your bank while you are fully employed and have a track record of regular income than you will in the first few years as a self-employed owner of a new business.

9. **Tax Accounts and Business Permits.** Depending on the nature of your business, you should promptly set up the required federal and provincial tax accounts, the most common of which are: (1) corporate income taxes; (2) federal goods and services taxes (GST); and (3) provincial sales taxes (PST). If you are paying employees, it is recommended that you engage a company that provides payroll software services to manage the statutory required employee source deductions and remittances, and the annual T4 income tax forms. Finally, most businesses also need to obtain a business licence from the municipality where its offices are located. This is often overlooked, and sometimes with embarrassing consequences.

10. **Workers' Compensation Board.** If you will be employing people to work for you or your company, it is very important to register with the Workers Compensation Board. Failure to register can result in fines to your business and, if an employee is injured in the course of their employment duties, can result in significant personal liability to the business owners.

11. **Reserve Web Domain.** Before you tell the world your new and exciting name for your company or business, check out to see if the domain name you want is available. The costs to register a domain name are relatively nominal, so it is strategic to register the domain name early on in the process. If possible reserve both the .com and .ca versions of the domain name.

12. **Cash Flow.** Revenue is vanity, profit is sanity and cash is king and the lifeblood of any business. Purchasing a good accounting system for your business so that invoices can be issued in a timely manner and account receivables can be tracked and followed up on as required is essential. While this is one of the most boring aspects of running a business, it is one that is critical for success and its neglect often leads to Titanic type outcomes. If this type of work gives you too many headaches, hire a good bookkeeper.

Hopefully the above list will help you guide your new ship safely on its maiden voyage to highly profitable and personally rewarding business dealings.

If you are in the strategic planning phase of your business startup or you have already launched and realize you need some immediate legal assistance, we would be pleased to meet with you and discuss how we can assist you in navigating your new business owner environment and to maximize your opportunity of financial success. We offer a variety of different fee arrangements (including fixed fee arrangements and deferred payment plans) that are designed specifically for new business owners.

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