

# Pitfalls of Incorporating without following Professional Advice

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## Filing articles of incorporation

The Companies Office is the corporate registrar in the Province of Manitoba. Over the past several years, the Companies Office has migrated many of their services online in an effort to streamline the filings process.



One such filing that has moved online is the filing of articles of incorporation, which creates a new corporation. The focus of this article is on the incorporation process.

Depending on your desired corporate name, you may need to wait for name approval from the Companies Office before the corporation can be registered. However, if you are comfortable using a numbered corporation and do not care to use a specific corporate name, the Companies Office online portal will allow you to register a new corporation immediately – no signatures required, no approvals necessary.

## Specifics for incorporating

The name of the corporation is not the only item required in order to file articles of incorporation. There are a number of specifications for the new corporation, including the:

- Address of the registered office.
- Minimum and maximum number of directors.
- Authorized share classes, number of shares for each class and rights/restrictions for each class.
- Names of the first directors.
- Restrictions on the business the corporation can undertake.

If you have never been through the incorporation process, the Companies Office provides step-by-step instructions and sample clauses for you to utilize.

If you are an entrepreneur, this expediency is certainly valuable. However, the immediacy of the Companies Office online process, together with the detailed guidelines provided by the Companies Office, now appears to give individuals the sense that professional advice is no longer needed when incorporating a new business.

The plethora of information provided by the Companies Office is valuable. However, the Companies Office still notes that the incorporation process is complex, stating:

“Pre-defined clauses often used by incorporators that are acceptable to the Director to cover some very basic kinds of share structures have been provided. These example structures may not meet all the legal and financial requirements of your situation. Therefore, you should contact a lawyer or accountant to determine what may be best for you.”

## Initial organization

The process of incorporation does not end after filing the articles of incorporation. This is simply the beginning. The next step is to do an initial organization of the corporation, which is just as important as the registration itself. The initial organization includes:

- Issuing shares.
- Electing officers.
- Drafting security, director and officer registers.
- Adopting by-laws.
- Appointing or waiving the need for an auditor for the first fiscal period.

These examples illustrate the importance of consulting a professional when incorporating a business. The simplicity of filing articles of incorporation can often leave individuals with the false sense of security that they have created a new corporation that is ready to conduct business, when in reality, without being properly organized, the new corporation is but a shell.

## Future problems with corporate structure

The writers of this article have experienced situations where individuals, without the assistance of a professional, filed articles of incorporation online and believed the process was complete, only to find out later that much more was required. Individuals often learn of these further requirements when they attempt to borrow money from a financial institution, only then realizing that they had not adopted the necessary “Borrowing By-Law” for the corporation (amongst other shortcomings). At this point, a professional is usually brought in at the advice of the financial institution.

Another issue that frequently arises relates to the specifics of the articles of incorporation that are filed. Frequently articles of incorporation do not accurately reflect what is required for the nature and structure of the business. For example, an individual may think they are the sole director, and therefore fix the minimum and maximum number of directors at one. However, doing so will restrict the corporation in the future. This individual has failed to consider whether additional directors may be elected later. If they wish to add a director (or

directors) in the future, they will be required to file articles of amendment with the Companies Office, which costs both time and money.

Even more significant problems can surface relating to the available share classes and share rights. These items are very important, and unless you have specific experience with the incorporation process, you may not realize exactly how these items could impact your business in the future.

For instance, a corporation created with only one authorized class of shares will be limiting their options in the future, as that one class will hold all the mandatory rights specified under subsection 24(4) of *The Corporations Act*, CCSM c 225 (the “Act”). Two potential future scenarios that may be impacted by this decision are:

1. If a shareholder is added in the future, oftentimes you may wish to issue the new shares in a different class to limit the incoming shareholder to nonvoting shares. This option will not be available if you only specify one authorized class of shares in the articles of incorporation.
2. If you desire to roll over personally owned property to the corporation on a tax-deferred basis using the Income Tax Act, RSC, 1985, c 1 (5th Supp), you will need to issue certain shares, usually called “Preference S hares,” as consideration for such a rollover. Again, this option would not be available unless your authorized share classes and rights allow for it when the corporation is created.

In each of the examples above, before achieving the desired outcome, you would first be required to file articles of amendment with the Companies Office to expand the authorized classes of shares.

## Conclusion

From a pure cost-benefit analysis, the future cost of rectifying a poorly setup corporation will frequently outweigh the initial costs if a professional had been consulted at the outset.

Lawyers and professionals alike strongly urge individuals to seek legal advice when incorporating a business. If you engage a professional to assist with the incorporation process, the articles of incorporation will be filed to meet the specific needs and nature of your business. Additionally, there are numerous statutory requirements for corporations under the Act in Manitoba, many of which you may be unaware of. The Act consists of 376 sections and is by no means straightforward. The Companies Office online service is a valuable tool; however, the ease of filing articles of incorporation should not be perceived as a substitute for professional advice.

Unfortunately, incorporation is not a simple process. It is a long-term investment, and if you do not start the right way, issues, both big and small, may soon follow.

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