

Jurisdiction of Incorporation: Some Points to Consider in Making an Informed Choice

There are several options available when creating a new legal entity in order to carry out an investment project or operate a business.

One can invest in a project or operate a business in one's own name or act through a general partnership, a limited partnership, a trust or a legal person.

VEHICLE SELECTION

The vehicle selected will depend, among other things, on an analysis of the various financial, fiscal and legal advantages and risks the project entails. A consideration of the legal liability of the parties involved will often convince them to act through a legal person.

Indeed, a company has a juridical personality that is separate from that of its directors and shareholders. Consequently, barring fraud, abuse of rights or contravention of a rule of public order,¹ or barring the existence of a personal guarantee, the shareholders of a company will be liable for the debts and obligations of the company only to the extent of their investment.

Once it has been decided to use a company, a common question arises: in which jurisdiction should the new legal person be incorporated?

In accordance with the Canadian constitution which provides for shared jurisdiction over corporate matters, the Canadian government and the government of each of the provinces have passed laws for the creation and governance of legal persons.

In Québec, two corporate statutes are often used, namely Part 1A of the **Companies Act**ⁱⁱ (the "Québec Act") and the **Canada Business Corporations Act**ⁱⁱⁱ (the "Federal Act"). Both statutes have similarities and differences and, therefore, advantages and disadvantages.

PRESENT OR FUTURE PROJECTS

One of the elements to consider in this type of situation is the jurisdiction governing the companies related to the project in question as well as the companies which will be the future subsidiaries or corporate shareholders of the company to be created. To the extent possible, it is

Me Mylène Henrie works with the lawyers in our Business Group on major files dealing with mergers and acquisitions, shareholder agreements as well as the organization and reorganization of businesses. Me Henrie's expertise is also called upon in files involving due diligence reviews.



preferable to plan for potential future reorganizations, particularly amalgamations, so as to reconcile the jurisdictions of incorporation of the various companies involved. Indeed, when an amalgamation is required, only companies created under the same jurisdiction can amalgamate, since corporate laws strictly prohibit any amalgamation between legal persons governed by different statutes.

Insofar as the other jurisdiction involved provides a reciprocal right, the Federal Act allows a company governed by the Federal Act to be continued under the statute applicable in the other jurisdiction and it allows a company governed by a statute applicable in the other jurisdiction to be continued under (or imported into) the Federal Act. However, the Québec Act does not permit the continuance or exportation of companies under or outside its jurisdiction. Accordingly, a federal company and an Ontario company—for example—could amalgamate if the Ontario company were continued under the Federal Act and subsequently amalgamated with the federal company. However, such a reorganization could not occur between a federal company and a Québec company. It would be necessary to liquidate the assets and liabilities of one of the companies into the other in order to be able to operate their businesses under a single entity.

RESIDENCE OF THE COMPANY'S DIRECTORS

The residence of the company's directors is another element which must be checked prior to incorporation. The Federal Act requires that 25% of the members of the board of directors of a federal company be Canadian residents. Under the Québec Act, the board of directors may be composed entirely of non-residents of Canada. It should be

noted that the residence of the directors of a legal person is merely a corporate requirement under the two statutes in question and should not have any impact on the criteria to be considered from a fiscal point of view, that is, whether or not the company qualifies as a “Canadian corporation” or a “Québec company”.

LOCATION OF THE HEAD OFFICE

The location of the head office of the legal person is also a factor to be considered. Although it is possible to carry on business anywhere in Canada or the world through a Québec or federal company, the Québec Act requires that the head office of a company governed by it be located in the Province of Québec, while the Federal Act requires that the head office be located in Canada. It should be noted that a company, whether it is governed by the Québec Act or the Federal Act, will have to register in each province in which it wants to carry on business in order to comply with legislation in force in each of the provinces with respect to the registration of extra-provincial companies carrying on business outside the province where their head office is located. The same type of legislation is in force in most countries. Accordingly, a Québec or federal legal person carrying on business internationally must generally register itself in the countries in which it carries on business.

PROTECTION OF MINORITY SHAREHOLDERS' INTERESTS

The level of protection of minority shareholders' interests is a significant difference between the Federal Act and the Québec Act. Indeed, the Québec Act does not contain any specific rights or recourses in favour of minority shareholders, while the Federal Act maximizes their rights and recourses. Consequently, the Québec Act tends to favour majority shareholders while the Federal Act is generally preferable when considering the situation from the point of view of minority shareholders. Of course, it is possible to supplement the Québec Act by granting additional rights to minority shareholders, through a shareholders' agreement, for example. Moreover, the case

law has tended to try to compensate for the gaps in the Québec Act by developing general principles regarding the protection of minority shareholders' interests. However, the principles arising from the case law do not provide minority shareholders with the same level of rights or protection.

COSTS

We have intentionally chosen not to discuss the difference in the costs relating to the creation and annual maintenance of legal persons, firstly, because there is not much of a difference and, secondly, because we believe that the choice of the jurisdiction of incorporation of a legal person should not rest on financial grounds, but rather on the results of an analysis of the various legal advantages and disadvantages. In fact, if the choice is made too quickly, correcting any errors can be much more costly.

UNLIMITED LIABILITY COMPANY (“ULC”)

We will conclude with a brief word on the Nova Scotia Unlimited Liability Company (“ULC”). This vehicle can prove highly advantageous from a fiscal point of view in situations in which American shareholders invest in a Canadian corporation. Indeed, for purposes of Canadian taxation statutes, ULCs are legal persons, but for the American tax authorities, they are partnerships (flow-through entities). From a legal perspective, it should be noted that although the liability of the shareholders of a ULC is unlimited, such liability will only arise upon the liquidation of the ULC and only if its assets are insufficient to cover its debts. Furthermore, certain contractual mechanisms can be put into place in order to minimize the unlimited liability of the shareholders of a ULC, for example, by ensuring that each time the ULC contracts with third parties, the third parties agree to limit their recourses to the assets of the ULC.

ⁱ Article 317 of the *Civil Code of Québec*.

ⁱⁱ R.S.Q., c. C-38.

ⁱⁱⁱ R.S.C. (1985), c. C-44.



1000 De La Gauchetière Street West, Suite 2900
Montréal, Québec H3B 4W5 CANADA
Telephone: (514) 878-4311 Fax: (514) 878-4333
www.dgclex.com

Please contact us for more information
regarding this article.

For the list of the lawyers in our Business
Practice Group, please click on:

[De Grandpré Chait - Business Group](#)