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The Learning Kurve

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Company Shares

Owners/managers of incorporated businesses know that they own the company, but at times may not be as familiar with some of the concepts regarding shares.

Under the Canada Business Corporations Act (CBCA), a corporation will issue shares. The corporation is not required to have common shares, special shares or preferred shares, but rather it is only required to maintain shares. Most of the provincial legislations regarding share capital are very similar to the CBCA; however, there are differences. It is important to ensure that the corporation properly complies with the laws of the jurisdiction under which it is incorporated.

In many private companies, the owner/manager controls the corporation and may be the only shareholder. However, as the corporation is considered to be an entity unto itself, the shareholder must not treat the business as if its assets were the assets of the shareholder.

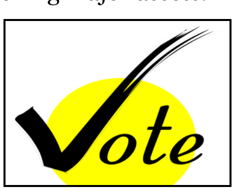
Generally there are two types of shares issued from a corporation—common shares and preferred, or special, shares.

Common Shares

Where a corporation maintains only one class of shares, these shares must be entitled to vote at meetings of shareholders and must be entitled to the residual value of the corporation on liquidation. These shares are common shares. If there is more than one class of shares, it is possible to separate these attributes.

Common shares represent the residual capital in the assets and earnings of a business. Traditionally each common share has one vote. In most owner-managed businesses, the original common shares issued would have nominal value, for example $1 per share.

Common shareholders have the final say in the operations of a company. Normally a 51% majority is required to approve major events in a company, such as electing directors, liquidating the company or selling major assets.



Rights of Common Shareholders

There are certain rights or advantages to being a common shareholder. These rights or advantages can be modified within the bylaws or within the shareholders' agreement but generally include:

- The ability to dispose of share holdings;
- The right to vote;
- The right to elect directors;
- The right to attend company meetings;
- The right to receive copies of the company's annual report and financial statements;
- The right to share in the company's growth, earnings or assets of the company; and
- The expectation of limited liability.

These rights are not without a cost. Common shareholders can have no expectation in the profits of the company unless the dividends are declared by the directors. If a company is doing well, dividends are usually paid out of profits. Conversely, if profits do not exist, the company will not declare a dividend, and in some instances, may be prohibited from doing so. Adding to this risk is that, should the company not be successful, common shareholders have little hope of recouping any of their original investment.

Many start-up entrepreneurs issue common shares to family members. This may be done, for example, to provide the ability to declare dividends to more than one person.

When considering the share structure of the company, the owner/manager should consider the rights of all common shareholders. Regardless of the number of shares held, common shareholders have rights that, if exercised, could create operational headaches for the majority shareholder.

Special Shares

Special, or preferred, shares have a differentiating factor in the special right or rights attached to these shares. For example, if a share is entitled to priority on liquidation, this share would be viewed as having preference over other shares. There are many attributes that can be attached to special shares. For example, they may not be entitled to vote at a meeting of the shareholders or may be restricted in the dividends that can be received.

Special shares are usually designed to be more secure than common shares that carry no guarantee as to their worth or the return on investment. For instance, it may be that the special shares must be paid a return of 5% before common share dividends could be paid out.

For most owner/managers, the use of special shares is not considered in the original incorporation of the company. Later, as a company becomes more successful and starts to accumulate value, special shares, along with common shares, may be used to create holding companies to protect the assets of the operating company and, therefore, the shareholder (owner/manager). This reorganization is often referred to as a Section 85 rollover as it utilizes that section of the Income Tax Act.

The Shareholders' Agreement

The shareholders' agreement governs the rights and obligations of the shareholders and, as such, is a very important document. Together with the many provisions specific to the corporation that are contained in this agreement, some rights and obligations arise due to the governing legislation. If the corporation is provincially incorporated, the applicable provincial legislation will apply. If the corporation is federally incorporated, the federal legislation will apply.

The agreement usually covers such matters as the amount of issued stock, names of shareholders and the amount and class of shares that they own. Other matters include necessary approvals by shareholders, nominees of shareholders and buy/sell provisions, as well as organizational matters such as number of directors, name of chartered accountant, location of books and records, and the cap on indebtedness that the corporation can incur.

Regardless of whom the shareholders are, whether your spouse, friends or business colleagues, it is imperative to have your lawyer draft a comprehensive shareholders' agreement. Areas that may be addressed include matters such as the amount of capital invested, the ability to sell shares to outside parties, distribution in the event of the death of a shareholder, and operational responsibilities, such as signing authorities, debt and capital purchases. Formalizing these issues in the agreement will reduce the likelihood of conflict during operations and will provide guidance in the event of the death of one of the shareholders.

Be sure to get advice from your lawyer and chartered accountant to determine the best means of protecting the rights and privileges of the company's shareholders now and in the future.

Wishing everyone a safe and enjoyable summer!!