

BUSINESS STRUCTURE AND CORPORATE FINANCING

FINANCE MINI MBA FOR THE PUBLIC SECTOR

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Federated Press

Business Structure and Corporate Financing

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- There are eight types of business structures in Canada
 - ▣ Corporation – Federal or Provincial
 - ▣ Unlimited Liability Company – Alberta, Nova Scotia, BC
 - ▣ Limited Liability Company – no provinces
 - ▣ General Partnership – all provinces
 - ▣ Limited Partnership – all provinces
 - ▣ Limited Liability Partnership – usually limited to professionals
 - ▣ Joint Venture – unincorporated
 - ▣ Business Trust – all provinces

Benefits and Principles of Each Structure

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Corporation

- Is a separate entity for legal and tax purposes in nearly all countries.
- Immensely flexible, can have from one to a million shareholders.
- Each owner's liability is limited to the amount invested.

Benefits and Principles of Each Structure

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Unlimited Liability Company

- Is a separate legal and tax entity in Canada.
- But is flow through for taxes in U.S.
- Usually used by U.S. investors in Canada.
- Often for start-ups.
- Each owner has unlimited joint and several liability for all the entity's obligations.

Benefits and Principles of Each Structure

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Limited Liability Company

- No province creates LLCs.
- Common in many other countries.
- U.S. created LLC, resident in Canada, are common for U.S. business in Canada.
- For tax purposes considered a corporation in Canada, partnership in the U.S.

Benefits and Principles of Each Structure

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General Partnership

- Is a separate legal but not tax entity.
- Each partner is jointly and severally liable for all obligation.
- Taxable income (and losses) flows through to partners as set out in their agreement.

Benefits and Principles of Each Structure

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Limited Partnership

- A separate legal but not tax entity.
- Two types of partners.
 - ▣ Limited partners – Investors that may not manage.
 - ▣ General partners that manage whether invested or not.
- General partners jointly and severally liable for all obligations.

Benefits and Principles of Each Structure

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Limited Partnership (continued)

- Usually has a corporate general partner with a very small capital and profit interest.
- Can undertake a public offering of units.
- Numerous master limited partnerships actually traded on stock exchanges in the U.S.

Benefits and Principles of Each Structure

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Limited Liability Partnership

- A separate legal but not tax entity.
- Mainly available for professions (in Ontario, only lawyers and accountants).
- Depending on the jurisdiction, some or all partners have limited liability.
- For example, no partner is responsible for another's misconduct or negligence.

Benefits and Principles of Each Structure

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Joint Venture

- Used mainly in the resource and real estate industries.
- Common for single buildings and oil or gas fields.
- Assets are often legally held by a corporation which does not have any beneficial interest but acts as a “Bare Trustee”.
- Not a separate legal or tax entity.

Benefits and Principles of Each Structure

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Joint Venture (continued)

- Participants hold a designated percentage of each asset and related income expenses (may not all be the same) rather than in the net assets or profits (losses) of the entity.
- Liabilities are limited to specific items.
- They may manage or not.

Benefits and Principles of Each Structure

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Business Trust

- A separate legal not tax entity.
- Often used for passive (real estate or marketable securities) holdings.
- Normally flow through for taxes.
- Similar foreign entities such as European Anstalt may be considered corporations for tax purposes.

Benefits and Principles of Each Structure

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Business Trust (continued)

- Beneficiaries have no liability for obligations.
- Usually have a corporate trustee and separate management firm.
- Managers can be beneficiaries.

Choice of Structure

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- Normally tax driven.
- If initial losses are expected some form of limited partnership is used often followed by rollover to a corporation.
- If U.S. investors are involved a corporation is preferable as flowing losses across U.S. border may be difficult.

Choice of Structure

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- Affected by number of investors.
- Many partners are administratively complex.
- Corporations much easier.
- Usual cut-off is 20 investors.

Choice of Structure

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- In resource industries ownership of assets is important for tax write-offs.
- Cost to operate mine or oilfield reduced by operational consolidation (unitization).
- Two joint venture structures Corporate (co-ownership with the Base Trustee) or unincorporated (everybody on title) are very common.

Choice of Structure

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Example 1

- Oilfield operated by one firm.
- Individual wells owned by 15 participants.
- Revenues and costs allocated by ownership of wells.
- Each participant keeps own tax Adjusted Cost Base for every asset.

Financing

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- Canadian businesses have four basic types of financing.
 - Bank Loans
 - Other debt
 - Strategic equity
 - Financial equity

Financing

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- Banks in general will loan to:
 - Corporations – often with shareholder guarantees.
 - General Partnership
 - Limited Partnership
 - Limited Liability Partnership with partner guarantees.

Financing

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- Banks find it difficult to understand:
 - Unlimited Liability Companies
 - Limited Liability Companies – foreign entities
 - Joint Ventures – loans made directly to participants or through a stapled corporation.

Financing

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Other Debt

- Based on the lender and type of collateral all business structures can usually be financed at a price.

Financing

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- Strategic equity covers investments by:
 - Managers
 - Employees
 - Customers
 - Suppliers
 - Industry participants
 - Venture capital
 - Private equity

Financing

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- Financial equity covers investments by:
 - Friends and family
 - Lenders
 - Public shareholders

Financing

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Example 2

- Buyer undertakes \$5,000,000 of work to earn 10% interest in mineral property or particular project.
- Once feasibility of a project established often a major producer may earn a significant interest by arranging senior and mezzanine financing supervising construction and operating the property.
- Farm-in very common type of early stage resource financing.

Valuation of Goodwill for Tax

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ANY QUESTIONS ?