

## **LIMITING BUSINESS RISK**

*by Robert G. Sly  
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An important responsibility of the management of any business is to reduce or eliminate business risk. One of the most basic ways in which to achieve a reduction in business risk is to use a holding corporation.

A holding corporation (“Holdco”) is typically a corporation which owns all the shares of a second corporation (“Opco”) which carries on the business.

If one is setting up a business, it is often useful to use this sort of structure. Typically, two corporations would be incorporated, one would become Holdco and the other would be Opco. The founders would own all the shares of Holdco. Holdco would own all of the shares of Opco and all the assets Opco would need in its business. Holdco would then lease the operating assets to Opco.

The existence of the lease helps reduce the business risk of Opco. This is because any liability to which Opco is exposed should not attach to the assets it leases from Holdco.

In addition to reducing business risk to operating assets the Holdco/Opco structure can be used to reduce the business risk attaching to the cash assets Opco produces. This is done by ensuring that all the excess cash produced by Opco is paid by way of dividend to Holdco. Any liability of Opco which arises after the date of the dividend, subject only to certain special rules, should not attach to any monies received by Holdco by way of dividend from Opco.

If Opco has need of money in its business, such as for bonding purposes, then the required sum could be lent by Holdco to Opco for Opco’s use. This loan would be secured by Holdco by the filing of a registration in the Personal Property Registry here in Manitoba. The filing of the security would ensure that Holdco would have a priority claim against these monies over non-secured creditors of Opco.

It is important to understand that this structure would be reviewed by any financial institution lending money to Opco or any bonding company involved with Opco. Often such lenders and sureties will insist on having a pre-emptive charge against the assets of Holdco to secure any debt, credit or other support extended to Opco. Such a charge will frustrate the goal of the Holdco/Opco structure but only against those creditors who can insist on a charge against the assets of Holdco.

This structure can also be implemented where business is being carried on by a single corporation (“Oldco”). In that circumstance, Oldco would incorporate a subsidiary (“Subco”). Oldco would own all of the shares of Subco. Oldco would then transfer to Subco, on a tax deferred basis, the business of the Oldco except for the operating assets. Typically, this would mean a transfer of only the goodwill of the business and perhaps a right to use Oldco’s name. Oldco would then change its name. The operating assets owned by Oldco would then be leased to Subco. Subco could then pay dividends to Oldco and the cash aspect of the plan could be utilized as well with secured loans as required.

The structures described above minimize the business risk a corporation faces by limiting the exposure of its business assets and its cash to the liabilities the business might produce. Management of any start up or existing single entity business should investigate implementing this structure as an inexpensive means of limiting exposure to business risk.

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