

FACTSheet



HOW TO INCORPORATE A CO-OP IN ONTARIO



Introduction

Incorporation is a process that grants your organization legal rights and recognition under the law - similar rights as are granted to a person. Incorporating an organization as a co-operative provides some formality and protection to the organization.

Being incorporated gives the co-operative the ability to purchase assets, take on debt and it can make it easier to raise capital. It is not necessary for a group to incorporate if they wish to operate as a co-op on an informal basis, but in order to have the legal protection that incorporation provides or to be able to use the word 'co-op' or 'co-operative' in the name of a group, it must be incorporated formally.

There is special legislation in Ontario, called the *Co-operative Corporations Act* (commonly referred to as *the Act*), which dictates how co-ops can operate and what is required in order for an organization to be considered a co-op under the law. If an organization wishes to be legally considered a co-op in Ontario, they must follow a certain process and the requirements of the Act. This process is regulated by the Financial Services Commission of Ontario (FSCO), an agency of the Ontario Ministry of Finance.

The actual process of incorporation is fairly simple, but there are some things that a potential co-op should do before beginning the incorporation process. A group may wish to engage the services of a lawyer to assist in drafting the articles of incorporation. It may also be advantageous to consult with an accountant as part of the financial planning process associated with incorporation.

Before You Start the Process

Taking Your Idea into Action

Incorporation is a process that requires a minimum number of people – for most types of co-ops, at least five people are required to incorporate, and in the case of worker co-ops three or more people are required. Even though it may only take one or two people to come up with an idea for a co-op and do the initial groundwork, it is

important that you involve others in your community from the start. This will allow other interested people to join with you and help develop the co-op.

Feasibility of the Idea Behind the Co-op

A co-op is a business enterprise, albeit with a potentially different set of priorities than a typical private corporation. Therefore, it is important that the group wishing to proceed with incorporation has done some work to determine if the idea that they have for the co-op is feasible and that it will be financially viable. It is also important to engage the services of an accountant or someone with financial experience in co-operatives to assist in setting up appropriate share structure. Engaging the services of a Co-operative Developer are highly recommended. You will need to be able to answer such questions as:

1. **Who are your members?** Are they the people producing the goods and services, or are they the people buying the products? Will this co-op be a worker-owned enterprise, where the members are both the owners and employees? Is the co-op going to be providing housing and the members will be the owners of the building and/or the occupants of the building?
2. **What products or services are you offering?** How will prices and setting costs be handled, and where is the revenue coming from? How will new services or products be evaluated or added to the co-op's operations?
3. **How will your co-op finance its start-up costs?** Solely through member investment or through combinations of sources? What are the co-op's potential sources of income? Does the co-op need to raise equity or borrow money? Is equipment or land required?
4. **What will your operating costs be?** Where will you be housed? What are start-up costs and ongoing costs? Will the revenue be sufficient to cover the ongoing costs?

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The group should also prepare income statements, cash flow statements and balance sheets as a way to document the estimated financial situation of the co-operative.

With or Without Share Capital?

This is one of the critical decisions that the co-op will have to make. When a co-op incorporates, there are two choices – incorporating with share capital or without. This decision is based primarily on what the purpose of the co-operative is, and what types of financing is needed for the projects and operations of the co-operative.

Share capital refers to shares offered by the co-operative to members or to outside investors. Share capital is generally referred to as equity financing, and is usually used to buy equipment, land, buildings or other fixed assets that the co-op might need. When members or investors buy shares, they receive a return on their investment in the form of dividends – provided the co-operative has earned enough surplus to justify them.

Incorporating without share capital means that the co-op may have to rely on debt financing in order to get money. Shares cannot be offered to members or investors to raise money. This type of co-op structure is suited to covering operating expenses such as supply purchasing or inventory requirements. It is possible to purchase equipment and fixed assets using debt, but it can be more difficult to do so.

Co-ops can use a combination of debt and equity to financing their operations, as assets purchased with raised equity can be used as collateral to obtain debt. Understanding what financing will be needed for your operations will dictate whether or not you need to incorporate with share capital or without.

For-profit or Not-for-Profit?

For-profit and not-for-profit status are not defined by the Ontario *Co-operative Corporations Act*, they refer to tax status and is defined by the Canada Revenue Agency. A not-for-profit entity carries on business with a mandate that does not include providing a benefit to members – any surplus or profit that is generated must be used to carry on the mission of the co-op, and not distributed to

members. Many day care and housing co-ops operate as not-for-profits in order to have access to government funding, but there are other co-operatives in Ontario that choose a not-for-profit tax structure as part of their philosophy about operating.

Although not regulated by the Ontario Act, the decision about whether to operate as a not-for profit co-op has to be made before incorporation, as there is specific text that must be included in a co-op's Articles if they are going to be operating as a not-for-profit.

The Process

The actual process of incorporation involves the creation of Articles of Incorporation, which are submitted to FSCO along with name search information, consent forms for directors that are not serving as incorporators, and required fees.

The Articles of Incorporation

The Articles of Incorporation include prescribed information about the co-operative:

1. If it is incorporated with share capital or without share capital.
2. Where it is located and operates.
3. The names of the incorporators and details about the board of directors.
4. Details on how the co-op finances itself, and expected member contributions.
5. Any special restrictions or provisions that apply to the co-op.

There are two different templates to use, one for co-ops with share capital and another for those without share capital. For the most part, the templates are the same for both types of co-operative, with the sections of the Articles that relate to financing being the major difference between the two.

For co-ops with share capital, the Articles have to outline the price of shares offered by the co-op, the amount of capital being raised by each type of share, both membership and preference shares. The Articles must also outline the rights, conditions and restrictions associated

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with each type of share – including how shares can be transferred.

In the case of a co-operative without share capital, the Articles need to outline the cost of the membership fee. Instead of referring to limitations, limitations and issuance of shares, this template asks for information on the amount of member loans offered, and the restrictions on transfer of the loans.

If the co-op will be operating as a not-for-profit co-op, there is special language that must be written into the "Special provisions, if any, are:" section of the Articles. There is specific language needed for not-for-profit housing co-ops. For most other not-for-profits, the language is more general and usually makes reference to the fact that the co-op is carrying on business without the purpose of gain for its members and that surplus will not be distributed to members, it will be retained by the co-op to further its objectives.

Choosing a Name for Your Co-op

It may seem simple to choose a name for your co-op, but there are some external factors that need to be taken into account when choosing the official name. The name chosen for an incorporated entity shouldn't cause confusion with other organizations or companies. Co-ops must also use the word co-operative (or *coopérative* in French) in their official name.

In order to ensure that the name being considered satisfies these requirements, incorporation requires proof of a formal name search, and it must be done regardless of the type of co-op being incorporated. The group must include proof with their other incorporation documents that this name search has been done appropriately and that the proposed name is acceptable. There is a specific process that is generally acceptable to government agencies and departments for name searching, and is called a Newly Updated Automated Name Search or a NUANS search. These searches can be ordered from a firm or company that specializes in corporate or incorporation services or specifically in name searches and there is usually a fee involved.

Deciding on the Founding Directors of the Co-op

In most cases, the incorporators of a co-op act as its first directors, and will form the first Board. The number of directors listed in the Articles of Incorporation must be equal to the number of directors specified by the Articles, or fall within the range of directors specified.

However, in some cases, the co-op may have some directors serving that do not act as incorporators. For those that will act as directors but will not be listed as incorporators, their names need to be listed under the directors section only. They will also need to sign a form that shows that they have agreed to act as first directors. Those that are listed as both incorporators and first directors are not required to complete this form.

These are the initial directors of the co-op, and they sit on the board from the date of incorporation until the first initial Annual General Meeting of the co-op is held. This first meeting must happen within 18 months of incorporation. At that first meeting, the members of the co-op will elect a slate of directors to the board. The Act requires that once the first meeting has been held, that the membership come together to carry out business, including electing directors, on a nearly annual basis. Once the first meeting has been held, the members must meet again within 15 months – and AGMs must be held within 15 months thereafter.

Filing for Incorporation

Once all of the work has been done to prepare the co-op for incorporation, the appropriate forms can be submitted. The incorporators need to prepare:

1. 2 copies of the Articles of Incorporation, all with original signatures of the incorporators.
2. Copy of the NUANS name search report.
3. One cheque to cover the fees for incorporating, and one for the reservation of the name, both payable to the Ontario Minister of Finance.
 - a. Fees are reviewed yearly and are subject to change, but can be found at the FSCO website.

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4. 2 copies of signed declarations for first directors – if there are any directors that are not listed as incorporators, their signed declarations will need to be submitted. If this does not apply to your co-op, these forms do not need to be submitted.

The filing information should be sent to:

Licensing and Market Conduct Division
Financial Services Commission of Ontario
5160 Yonge Street,
PO Box 85, 4th Floor,
Toronto, ON M2N 6L9

After the information has been processed, a Certificate of Incorporation will be provided to the group, along with a copy of the Articles for the co-op's records. The Certificate of Incorporation provides the incorporation date and the Ontario Business Number, both of which are pieces of information that a co-op will need in its day-to-day operations.

Next Steps:

The letter that FSCO will provide with the Certificate of Incorporation will also include some guidance as to next steps. Once you incorporate, the co-operative will have to begin holding Board of Directors meetings and prepare to start operations (if not started already). The co-op will also have to prepare bylaws, hold an initial members meeting, and be aware of the requirements to hold an AGM.

The co-op will also have to submit the list of directors and corporate information to the Companies and Personal Property Security Branch of the Ministry of Government Services. This is called an Initial Return, and though designed for use with for-profit corporations incorporated under the *Business Corporations Act* and not-for-profit corporations under the *Corporations Act*, it also applies to co-ops. This information has to be filed yearly, and after the first submission of the Initial Return, the return is called a Notice of Change and only has to be filed to reflect changes in the board of directors or head office.

FOR MORE INFORMATION, CONTACT:

The Ontario Co-operative Association
450 Speedvale Avenue West, Suite 101
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info@ontario.coop www.ontario.coop

Le conseil de la coopération de l'Ontario
435, boul. St-Laurent, bureau 201
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Phone: 613.745.8619
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Quick Facts About Co-operatives in Ontario:

- There are over 1300 co-operatives, credit unions and *caisse populaires* incorporated and operating in Ontario, with 1900 locations in 400 communities.
- The co-operative sector in Ontario represents a very conservative \$30 billion in assets (2007). Non-financial co-ops had revenues that totaled more than \$2.1 billion in 2004.
- Ontario co-ops employ and provide benefits to 15,500 people (greater than the total number of Ontarians employed in production of goods).
- 1.4 million Ontarians are members of a co-operative, credit union or *caisse populaire* (more than 10% of the population)
- Over 10,000 board members are actively involved in governing and leading co-ops, credit unions and *caisse populaires* in Ontario.
- There are some 49,000 co-operative volunteers across Ontario, including board members.
- 50% of Ontario's co-ops are located in central Ontario.
- Housing is Ontario's largest co-op sector (45%), followed by Financial Services (17%), Child care (17%), and Agriculture (6%).
- Over 2,000 students at various post-secondary institutions live in Ontario student co-op housing, including Waterloo Region which is home to the second largest student housing co-operative in North America.

CHOOSING FEDERAL OR PROVINCIAL INCORPORATION



Introduction

Incorporating your organization as a co-operative provides some formality and protection to the organization. Incorporation is a process that grants your organization legal rights and recognition under the law - the same rights and privileges that are granted to a person. This gives the co-operative the ability to purchase assets, take on debt and raise capital for projects and operations. It also means that the co-op is now an entity that is subject to any restrictions or rules that are outlined in the legislation they incorporated under.

There is special legislation, both in Ontario and at the federal level, which dictates how co-ops can operate and what is required in order to be considered a co-operative under the law. In Ontario, this legislation is called the *Co-operative Corporations Act*, and at the national level it is the *Canada Cooperatives Act*.

Co-operatives can either incorporate at a provincial level or at a federal level, depending on how your organization meets different criteria about how and where you operate.

The Canada Cooperatives Act

The *Canada Cooperatives Act* is responsible for setting out the appropriate rules and procedures for federally-incorporated co-operatives. Matters that relate to this piece of legislation are administered by the Corporations Branch of Industry Canada, and therefore federally incorporated co-ops are also regulated by this body. However, in many cases, individual co-ops are bound by and responsible to other government agencies as part of their operations - like Revenue Canada for tax issues, or other government agencies that provide permits or regulation on specific parts of a co-op's operation.

The Ontario Co-operative Corporations Act

The *Co-operative Corporations Act* outlines the rules and procedures for co-operatives that incorporate and are

operating in the Province of Ontario. This legislation and the co-op sector in Ontario are regulated by the Financial Services Commission of Ontario, a division of the Ontario Ministry of Finance. As with the federal act, co-ops incorporated in Ontario are subject to this legislation, but may also be subject to other provincial or federal ministries for various aspects of their operations.

What is the Same in Both Acts?

One thing that both pieces of legislation have in common are the general definitions of what constitutes a co-operative and what it means to be organized and operate co-operatively. Both Acts define a co-operative as an organization that:

- Operates on a one-member, one-vote system;
- Has open and voluntary membership;
- Has limited interest paid out on member loans and limited dividends paid out on member shares; and
- Any surplus generated goes to further the objects of the co-op and/or is distributed to the membership based on their use of the service (referred to as patronage dividends or rebates).

No matter which Act you incorporate under, there is the same general commitment to co-operative principles and similar definitions about what being a co-operative means.

Main Difference Between the Two Acts

The main difference between the two acts is related to the geography of where a co-op operates.

In order to incorporate federally, a co-op must carry out operations in at least two provinces, and have fixed offices in more than one province. In comparison, incorporating in Ontario only requires a head office located somewhere in Ontario, with operations centered in Ontario.

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It is not necessary for co-ops to incorporate federally just because they are operating and have offices in more than one province. Incorporating federally may however provide additional protection from liability or more opportunities to raise capital and take on debts in more than one jurisdiction.

What Else is Different about Incorporating Under the Two Acts?

Although both Acts are similar in that they have restrictions about who can act as a founder when incorporating a co-operative, there are slight differences in the restrictions between the two acts.

The Canada Cooperatives Act (CAN):

- Requires a minimum of 3 people or corporations.

The Co-operative Corporations Act (ON):

- Requires a minimum of 5 people or corporations.

There are also differences in the forms required in order to incorporate, but both the federal and Ontario regulating bodies require the inclusion of a name search report that shows that the desired name of the co-operative has not been taken by another co-op or corporation or is not too similar to the name of another incorporated organiza-

tion already in existence. The federal incorporation process also requires a declaration that the incorporators will agree to carry on operations as a co-op, whereas the Ontario process does not require this.

The fees to incorporate in the two jurisdictions are also different. In Ontario, the fees are different depending on the form of the co-operative you are creating (with share capital vs. without share capital). The fees are determined by the regulating bodies for each act and are examined yearly and may be subject to change.

References:

Federal information kit and guidelines:

http://corporationscanada.ic.gc.ca/epic/internet/incd-dgc.nsf/en/h_cs02151e.html

Ontario guidelines and information:

http://www.fsco.gov.on.ca/english/regulate/co-ops/register_co-ops.asp

On Co-op has created a Guide to the Ontario Co-operative Corporations Act. Contact our office to learn more.

FOR MORE INFORMATION, CONTACT:

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- 1.4 million Ontarians are members of a co-operative, credit union or caisse populaire (more than 10% of the population)
- Over 10,000 board members are actively involved in governing and leading co-ops, credit unions and caisse populaires in Ontario.
- There are some 49,000 co-operative volunteers across Ontario, including board members.
- 50% of Ontario's co-ops are located in central Ontario.
- Housing is Ontario's largest co-op sector (45%), followed by Financial Services (17%), Child care (17%), and Agriculture (6%).

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CO-OPS ARE DIFFERENT FROM NOT-FOR-PROFITS



Introduction

Co-operatives are a unique type of business model that share some commonalities with both private corporations and not-for-profit organizations but there are some key differences between the three types of organizations in how they are organized and carry on activities.

In the case of co-ops and not-for-profit organizations (also called NFP organizations or NFPs), there are some similarities in their structures and in some cases, their tax status, but there are also differences in their organizational setup and how members benefit and are involved.

Primary Purpose

Co-operatives and NFPs are both member-controlled organizations that have missions and mandates other than solely maximizing financial return. However, the primary reason for a co-operative to exist is to provide a service or meet the needs of its members. NFP organizations have a much more broadly defined purpose that involves philanthropic, charitable, educational, scientific, or social objectives, which serve the greater community, not solely the organization's members.

In the case of NFPs with charitable objectives, there are additional regulations and tax and filing requirements related to charitable status that these organizations must maintain.

This FACTSheet does not address the particular issues associated with charitable NFPs but a FACTSheet related to co-operatives and charitable status has been created and is available from the Ontario Co-operative Association.

Legislation and Regulation

Co-ops

Co-operatives are subject to legislation called the *Ontario Co-operative Corporations Act*, and its associated regulations. Co-ops must operate according to the standards and

rules set out in this Act, and the Financial Services Commission of Ontario, an agency of the Ministry of Finance, oversees co-operatives and administers the *Co-operative Corporations Act*.

Not-for-Profits

NFP organizations incorporate as 'corporations without share capital' under legislation called the *Ontario Corporations Act*, which also has associated regulations. This Act and NFPs are regulated by the Companies and Property Security Branch of the Ministry of Government Services.

Tax Status

The tax status of an organization is dictated by the *Canada Income Tax Act* and overseen by the Canada Revenue Agency – not by the provincial legislation that covers incorporation and operation of co-ops or NFPs.

NFP organizations are exempt from the tax on the income that they earn. The income a co-op earns is subject to income tax, but some dividends distributed to members are deductible from the co-op's taxable income.

It is possible for a co-op to carry on business as a NFP from a tax perspective (i.e. under the *Income Tax Act*) and be exempt from income tax.

In order to qualify as a NFP for tax purposes, a co-op must clearly state in its Articles of Incorporation that it will not distribute surplus to its members and therefore is operating without benefit to its members – a key criteria for Canada Revenue Agency to consider it exempt from income tax.

Earning and distributing money

Investments and Securities

Co-operatives can incorporate with share capital or without share capital. Those that incorporate with share capital can offer investments in the form of shares which can be offered to both members (membership shares and

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preference shares) and outside investors (only preference shares). The sale of shares is dictated by the *Co-operative Corporations Act* and they are not traded on any market. NFPs incorporate without share capital and therefore cannot offer shares.

Revenue and Distribution of Surplus

Both co-operatives and NFPs can generate revenue from their activities. This revenue is used to purchase assets and/or pay the expenses of running the organization, including operational costs like staffing, maintaining an office, or any costs associated with carrying out activities that will further the organization's mission and mandate. Once all expenses have been paid, the money remaining is referred to as profit or surplus.

In a co-operative, the surplus can then be distributed to members in the form of a patronage payment. Patronage payments are distributed based on how much business a particular member does with the co-op. In a NFP organization, surplus cannot be distributed to members, it must be used by the organization on activities that further its goals and objectives.

Governance

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Although both co-ops and NFPs are member-controlled, there are some key differences in how this works in practical terms:

Voting

Each member in a co-operative has one vote at member and general meetings, no matter how much business a member does with the co-op or how many shares they may hold. This is one of the cornerstones of co-operative governance and it is enshrined in legislation.

Conversely, in an NFP, it is usually one vote per member, but in many cases, this is much more informal. NFPs also have the ability to provide the option for certain classes of members to have more than one vote each or no votes at all.

Boards and Structure

Both NFPs and co-ops have boards of directors that are elected by the membership, and in both cases, directors must be members of the organization.

References:

Comparison Chart of Co-ops, Businesses and NFPs – Created for the Ontario Co-operative Association by Brian Iler, Iler Campbell. LLP.

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