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WHITE PAPER

Choosing The Right Business Structure

The Strengths And Weaknesses Revealed

Four Types of Businesses

Before registering your business, it would be beneficial to consider the different options available to you. From a legal point of view, there are four types of businesses: Sole Proprietorship, Partnership, Corporation and Co-operative. Each has different and important implications for liability, taxation and succession.

Note: Information contained in this document is of a general nature only and is not intended to constitute advice for any specific fact situation. Readers concerned about the reliability of the information should consult your lawyer or accountant.

Sole Proprietorship

Sole proprietorship is the most common form and simplest way to set up a business. It is typically a business owned and operated by one individual who has complete control over its conduct and management. A sole proprietorship is not considered to be a legal entity, but rather is an extension of the individual who owns it.

The sole proprietor has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. A creditor with a claim against a sole proprietor would normally have a right against the sole proprietor's assets, whether business or personal. This is known as unlimited liability. All the income or loss of a sole proprietorship is considered to be the income or loss of the sole proprietor.

Advantages

- It is the easiest and least expensive form of business to own and operate because it does not require any specific legal organization, except of course, the normal requirements such as licenses, permits and registering with tax authorities.

- It typically does not have any rules or operating regulations under which it must function. The business decisions are solely the result of the owner's abilities.

Disadvantages

- The major disadvantage of sole proprietorship is that the owner is legally liable for all debts and actions taken against the business.

- Sole proprietorships have a limited ability to raise capital and are limited by the resources of the owner. Usually, as sole proprietorships begin to grow and expand, they become incorporated.

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2. Partnerships

A partnership is an agreement in which you and one or more people combine resources in a business. A partnership can take two legal forms, general and limited.

In a general partnership, two or more individuals join together to run the business enterprise. Each of the individual partners has ownership of company assets and responsibility for liabilities, as well as authority in running the business. Usually the partners are jointly responsible for all debts of the partnership. The authority of the partners, and the way in which profits or losses can be shared, is usually set out in a partnership agreement.

A limited partnership is comprised of general partners, who are personally liable for the partnership debts, and limited partners, who contribute capital and share in the profits or losses of the business, but do not take a part running the business and are not liable for the debts. Limited partnerships are usually established in situations where a considerable amount of capital must be raised. The limited partners contribute capital and share in the profits or losses, but they have no legal liability beyond their investment. The general partner(s) operate the company and are liable for the debts of the business.

In most partnerships, general and limited, the rights, responsibilities and obligations of all the partners are detailed in a partnership agreement. The agreement is very important especially since many partnerships fail because of disagreement among the partners about issues that should have been covered in the agreement.

A partnership does not file a tax return, but each individual partner is responsible for claiming his or her share of the partnership income or loss on their personal tax return.

Advantages

- The major advantages of partnerships are the benefits derived from pooling the skills of two or more individuals and the increased ability to raise capital.

Disadvantages

- The major disadvantage of partnerships is that the partners are legally liable for the debts of the business, with the exception of limited partnerships where the limited partners are only liable for their investment. Also, individual partners are not running their own business. They may have to compromise with the other partners in certain situations.

Corporation

A corporation also known as a limited company is a legal entity that is separate and distinct from its members (shareholders). It has all of the legal rights of an individual and is responsible for its own debts. It must file its own income tax return and pay taxes on income it derives from its operations. A corporation can be formed at either the provincial or federal level.

Advantages

- Usually the owners, or shareholders are protected from the liabilities of the business
- Possible tax advantage (if you qualify for a small business tax rate)
- Specialized management
- Ownership is transferable and usually easily changed. Shares may be transferred without affecting the corporation's existence or continued operation.
- Continuous existence with an unlimited life expectancy
- Separate legal entity
- Easier to raise capital such as through the sale of shares or by the transfer of assets to another corporation.

Disadvantages

- Closely regulated (for example the Business Corporations Act requires all companies to file an annual report and advise of any changes to the location of company offices and its directors.) The company is also required to maintain certain corporate records.
- Most expensive form of business to organize (higher start-up costs related to professional fees for legal and accounting services).
- Charter restrictions
- Extensive record keeping is necessary
- Possible double taxation of profits
- Shareholders (directors) may be held legally responsible in certain circumstances.
- Personal guarantees undermine limited liability advantage. When a corporation is small, major creditors will often request personal guarantees from the principal owners before extending credit

Cooperative

A cooperative is a form of corporation used for situations where the business will have "members" as opposed to "shareholders." Differences between a cooperative and a corporation include:

- A cooperative is organized and operated for the purpose of providing its members with goods and services.
- Regardless of the number of shares a member has, no member has more than one vote.
- The return on capital investment to the members is limited by legislation.
- Any surplus is usually returned to the members in the form of patronage dividends. Each member receives a share of that surplus in proportion to the amount of business done by the member with or through the cooperative.

Sources:
Business Service Centre, Government of Ontario   www.cbsc.org/ontario
Online Small Business Workshop, Government of Canada   www.cbsc.org/osbw
Small Business BC, Government of British Columbia   www.smallbusinessbc.ca