Proprietorship, Partnership or Incorporation?

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Starting a new business can be an exciting, yet daunting venture, especially when there are so many things to consider before you even get things going. When getting started, one of your first tasks will be to determine which business structure is right for you. Will you be a sole proprietor, will you operate a partnership or will you incorporate your company? To help you decide, we've made a list of the advantages and disadvantages to each business structure.

Proprietorship

Starting a **proprietorship** is the simplest way to set up a business. In a proprietorship, usually just one person performs all the functions required for the operation of the business. The proprietor secures the capital, establishes and operates the business, assumes all risks, accepts all profits and losses, and pays all taxes. The proprietor is said to be self-employed.

A sole proprietor is fully responsible for all debts and obligations related to his or her business. A creditor with a claim against a sole proprietor would normally have a right against all of his or her assets, whether business or personal.

Advantages:

- Low start-up costs
- Greatest freedom from regulations
- Owner is in direct control of decision making
- Minimal working capital required
- Tax advantages to owner
- All profits to owner

Disadvantages:

- Unlimited liability
- Lack of continuity in business organization in absence of owner
- Difficulty in raising capital
- No name protection

Partnership

A **partnership** is an agreement in which two or more persons combine their resources in a business with a view to making a profit. In order to establish the terms of the partnership and to protect partners in the event of a disagreement or dissolution of a partnership, a partnership agreement should be drawn up. Partners share in the profits according to the terms of the agreement.

Standard form partnership agreements can be purchased online.

Partnerships can be divided into 2 categories:

In a **General Partnership**, two or more owners share the management of a business, and each is personally liable for all the debts and obligations of the business. This means that each partner is responsible for, and must assume the consequences of the actions of the other partner(s).

A **Limited Partnership** involves limited partners who combine only capital. They are not involved in managing the business and cannot be liable for more than the amount of capital they have contributed. This is known as limited liability.

A limited partnership also involves general partners, who are involved in management. They are fully liable for the debts and obligations of the business, but may be entitled to a greater share of the profits.

Advantages:

- Easy to set up
- Low start-up costs
- Investment capital comes from more than one source
- Possible tax advantages
- Limited regulations
- Broader management base

Disadvantages:

- Unlimited liability for each general partner
- Divided authority between partners
- Difficulty in raising additional equity capital
- Hard to find suitable partners
- Possible development of conflict between partners
- Partners can legally bind each other without prior approval
- Lack of continuity in business organization in absence of partners
- No name protection

Incorporation

A **corporation**, also known as a **Limited Company**, is a legal entity which is separate and distinct from its members (shareholders). Each shareholder has limited liability. A creditor with a claim against the assets of the company would normally have no rights against its shareholders, although in certain circumstances shareholders may be held liable. It is recommended that legal advice be sought.

Ownership interests in a corporation are usually easily changed. Shares may be transferred without affecting the corporation's existence or continued operation.

The following characteristics distinguish incorporation from a partnership or proprietorship:

Limited liability – normally no member can be held personally liable for the debts, obligation or acts of the corporation beyond the amount of share capital the member has subscribed.

Perpetual succession – because the corporation is a separate legal entity, its existence does not depend on the continued membership of any of its members.

Advantages:

- Limited liability
- Possible tax advantage (if you qualify for a small business tax rate)
- Specialized management
- Ownership is transferable
- Continuous existence
- Separate legal entity
- Easier to raise equity capital

Disadvantages:

- Closely regulated
- Most expensive form of business to organize
- Charter restrictions
- Extensive record keeping necessary
- Possible double taxation of profits (corporate and personal tax)
- Shareholders (directors) may be held legally responsible in certain circumstances
- Personal guarantees undermine limited liability advantage

Keep in mind that starting a sole proprietorship doesn't mean you can't later incorporate your business when you determine a need. If you're still unsure about how each business structure would affect your business, consult your lawyer, accountant or a business advisor.