

Proprietor/Partnership vs Incorporation?

Before registering your business, it would be beneficial to consider the different options available to you. From a legal point of view, there are three common types of businesses: Sole Proprietorship, Partnership and corporation. Each has different and important implications for liability, taxation and succession. What are the advantages for your business of incorporating a company versus registering a Partnership or a Sole Proprietorship? We suggest you contact a lawyer or accountant if you are not sure which type of identity will meet your needs.

Please note that Sole Proprietorship and Partnership names have no statutory name protection. If name protection is important to you, you may wish to incorporate your business.

Advantages and disadvantages of Sole Proprietorship

There are a number of advantages and disadvantages that you should keep in mind when deciding whether to operate your business as a Sole Proprietorship. We encourage you to seek legal advice if you have further questions about operating your business as a proprietorship.

What is a Sole Proprietorship?

Starting a Sole Proprietorship is the simplest way to set up a business. As a sole proprietor you would be fully responsible for all debts and obligations related to your 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.

In a Sole Proprietorship, you would perform all the functions required for the successful operation of the business. These include:

- Securing the capital
- Establishing and operate the business
- Assuming all risks
- Accepting all profits and losses
- Paying all taxes

The sole proprietor is said to be self-employed.

Advantages of Sole Proprietorship

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

Disadvantages of Sole Proprietorship

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

Advantages and disadvantages of Partnership

There are a number of advantages and disadvantages that you should keep in mind when deciding whether to operate your business as a Partnership. We encourage you to seek legal advice if you have further questions about operating your business as a Partnership.

What is a Partnership?

A Partnership is an agreement in which you and one or more people combine resources in a business with a view to making a profit.

In a General Partnership, you and one or more other owner would share the management of a business, and each partner would be personally liable for all debts and obligations incurred. This means that each partner is responsible for, and must assume the consequences of the actions of the other partner(s).

Terms of the Partnership

In order to establish the terms of the Partnership and to protect yourself in the event of a disagreement or dissolution of a Partnership, a Partnership agreement should be drawn up. You can access some sample partnership agreements at the Small Business BC library, and standard form Partnership agreements can also be purchased from the bookstore at Small Business BC.

Profit sharing

You would share in the profits according to the terms of the Partnership agreement.

What is a Limited Partnership?

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. General partners are fully liable for the debts and obligations of the business, but may be entitled to a greater share of the profits

Advantages of Partnership

- Ease of formation
- Low start-up costs
- Additional sources of investment capital
- Possible tax advantages
- Limited regulation
- Broader management base

Disadvantages of Partnership

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

Advantages and disadvantages of Incorporating

There are a number of advantages and disadvantages that you should keep in mind when deciding whether to operate your business as an Incorporation. We encourage you to seek legal advice if you have further questions about operating your business as an Incorporation.

What is a corporation or limited company?

A corporation, also known as a limited company, is a legal entity that is separate and distinct from its members (shareholders).

Companies are incorporated in BC according to the provisions of the Business Corporations Act.

When a company is incorporated, it acquires all of the powers of an individual, an independent existence – separate and distinct from its shareholders, and an unlimited life expectancy. In other words, the act of Incorporation gives life to a legal entity known as the corporation, commonly referred to as a company. A company can acquire assets, go into debt, enter into contracts, sue or be sued.

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 a corporation from a Partnership or Sole Proprietorship:

- **Limited Liability:** normally no member can be held personally liable for the debts, obligations or acts of the corporation beyond the amount of share capital the members has subscribed.
- **NB:** 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. We recommend that you seek professional legal advice.
- **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 of Incorporation

- 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 capital

Disadvantages of Incorporation

- Closely regulated (For example, the **Business Corporations Act** requires all companies to file an annual report and also file 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 necessary
- Possible double taxation of profits
- Shareholders (directors) may be held legally responsible in certain circumstances
- Personal guarantees undermine limited liability advantage