Setting Up Your Business

Sole Proprietorship, Partnership or Corporation?

A business includes:

•a profession;

•a calling;

•a trade;

•a manufacture;

•an undertaking of any kind; and

•an adventure or concern in the nature of trade (for more information, see Interpretation Bulletin IT-459, Adventure or Concern in the Nature of Trade).

For income tax purposes, we define a business as an activity where there is a reasonable expectation of profit and there is evidence to support that intention. However, for GST/HST purposes, a business can also include an activity whether or not it is engaged in for profit and any regular and continuous activity that involves leasing property.

The three most common types of business structures are:

•sole proprietorship;

•partnership; and

•corporation.

The type of structure you choose has a significant effect on the way you report your income, the type of returns you file each year, and many other matters.

Sole proprietorship

A sole proprietorship is an unincorporated business that is owned by one person. It is the simplest kind of business structure.

The owner of a sole proprietorship has sole responsibility for making decisions, receives all the profits, claims all losses, and does not have separate legal status from the business.

If you are a sole proprietor, you pay personal income tax on all revenue generated by your business. You also assume all the risks of the business. The risks extend even to your personal property and assets.

You may choose to register a business name or operate under your own name or both.

Partnership

A partnership is an association or relationship between two or more individuals, corporations, trusts, or partnerships that join together to carry on a trade or business.

Each partner contributes money, labour, property, or skills to the partnership. In return, each partner is entitled to a share of the profits or losses of the business. The business profits (or losses) are usually divided among the partners based on the partnership agreement.

Like a sole proprietorship, a partnership is easy to form. In fact, a simple verbal agreement is enough to form a partnership. However, most partnerships are governed by a written agreement setting out rules for partners entering or leaving the partnership, the division of partnership income, and other matters.

The partnership is bound by the actions of any member of the partnership, as long as these are within the usual scope of the operations.

A partnership is considered to be a person for GST/HST purposes. Therefore, it is important that you structure your affairs in a clear and understandable manner, since your reporting and remittance of GST/HST will depend on the type of structure you choose. If you are a partnership, you may want to set up a separate bank account, have a written partnership agreement, and take other steps to make sure that it is clear that the business is not a sole proprietorship.

Corporation

A corporation is a separate legal entity. It can enter into contracts and own property in its own name, separately and distinctly from its owners.

A corporation may have some of the following features:

•It is a separate legal entity with a perpetual existence.

•It can generally raise larger amounts of capital more easily than a sole proprietorship or partnership.

•The shareholders cannot claim any loss the corporation sustains.

When forming a corporation, the owners transfer money, property, or services to the corporation in exchange for shares. The owners are referred to as shareholders.

You can buy and sell shares in a corporation without affecting the corporation's existence. A corporation continues to exist unless it winds up, amalgamates, or surrenders its charter for reasons such as bankruptcy.

You set up a corporation by completing articles of incorporation and filing them with the appropriate provincial, territorial, or federal authorities.

Are you responsible for your corporation's debts?

As a shareholder of your corporation, you have limited liability. This means that you and the other shareholders are not responsible for the corporation's debts. However, limited liability may not always protect you from creditors. For example, if a smaller, more closely held corporation wants to borrow money from a bank or other creditor, the creditor may ask for the shareholder's guarantee that the debt will be repaid. If you agree to this condition, you will be personally liable for that debt if the corporation does not pay it back.

This applies to taxes owing as well. If your corporation owes taxes and has obtained a loan or secured a line of credit, an advance under the loan or line of credit can be intercepted on account of the corporation's tax arrears. Notwithstanding that the proceeds of the advance have been paid to the receiver general for Canada, the corporation is deemed to have received the advance and is liable to the lender as such. When you have personally guaranteed the loan or the line of credit for the corporation, you would be liable jointly with the corporation for the amounts intercepted.

Directors may also be liable to pay amounts owed by the corporation if it has failed to deduct, withhold, remit or pay amounts as required by the Income Tax Act, the

Employment Insurance Act, the Canada Pension Plan, the Excise Act, 2001, and the Excise Tax Act.

***Source: CRA website, RC4070 Information for Canadian Small Businesses**