SMALL BUSINESS
STARTUP

Choosing Your Legal Structure

Once you decide to start a business, you need to choose what type of legal structure the business will have. The most common types are sole proprietors, business partnerships, corporations and cooperatives. The structure you choose will define your legal responsibilities, including paperwork and registration requirements, taxes and personal liability. Make sure to check your province's registration requirements. The following is an overview of each of the most common legal structures.

There are four main types of legal structures most people use when starting a business:

1. Sole proprietorship
2. Partnership
3. Corporation
4. Cooperative

Make sure you understand the advantages and disadvantages of each before deciding which is best for you.

Sole Proprietorship

A sole proprietorship is the easiest legal structure to set up for your business. Being a sole proprietor means that you alone own the business and are solely responsible for it. This also means that you will be fully responsible for all debts and obligations the business incurs, and creditors can make a claim against both your personal and business assets. There is no legal distinction between the owner and the business.

Advantages

- Inexpensive and easy to set up and start
- Low regulatory burdens
- No sharing of profits with anyone else

Disadvantages

- Unlimited liability (personal and business assets may be claimed by creditors)
- Hard to raise capital
- No other partners

Partnerships

If you want to do business with a partner (or partners), a business partnership may be a good option. You combine financial resources and share the responsibility for the business, including business losses and debts. It is advisable to write a partnership agreement between partners that lays out the structure of the partnership and the rights and obligation of each partner, including what happens if there is a disagreement or

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dissolution. Profits will be shared between all partners and according to the terms of your agreement.

Besides regular business partnerships, there are other types of partnerships available as well, such as limited partnerships and limited liability partnerships.

- A limited partnership consists of both general and limited partners. A general partner is one who is personally liable for all of the partnership's debts. A limited partner is only liable for the amount he or she initially invested in the business.
- In a limited liability partnership, partners are not personally liable for business debts. Partner liability is limited to the amount a partner invests into the business. The majority of limited liability partnerships are set up by professional services firms, such as accountants or attorneys.

Advantages

- Easy to start
- Share start-up costs between partners
- Share responsibilities and liabilities of running the business

Disadvantages

- Still have unlimited liability (personal assets may be claimed by creditors), although liability is split among the partners
- May be difficult to find suitable partners
- Possible conflicts between partners down the road
- All partners held financially liable for business decisions made by other partners

Corporations

A corporation is a separate legal entity that is set up to run your business, which limits your own personal liability for business finances, unlike a sole proprietorship or business partnership. Corporations have appointed directors who are responsible for running the company, and shareholders, or members who own shares in the company. The directors of a corporation have legal duties and responsibilities they must follow, including conducting business actions with a duty of care and acting in the company's best interest. The liability of a shareholder depends on the type of corporation. Incorporating a business can be done on a federal or provincial level.

Advantages

- Limited liability
- Separate legal entity
- Possible tax advantage
- Easier to raise capital
- Transferrable ownership

Disadvantages

- Strictly regulated
- More requirements, such as keeping detailed corporate records and filing documentation annually
- Possible conflicts between shareholders and directors

Cooperatives

Cooperatives are the least common form of business structure in Canada; however, they can be beneficial in certain situations. A cooperative is owned by an association of members, by a group of people or by businesses that decide to pool their resources together to provide access to common needs.

Advantages

- Controlled and owned by members
- Democratically run
- Limited liability
- Distribution of profits

Disadvantages

- Lower incentive to add capital
- Decision process takes longer
- More requirements, such as keeping detailed records
- Participation of all parties needed for success
- Possible conflicts between members

More Information

For more information on sole proprietorships, partnerships, corporations and cooperatives, visit www.canadabusiness.ca/eng/page/2853.