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Business Structure

Choosing the Right Business Structure

By Helen Hirsh Spence and Debra Yearwood

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One of the first and most important jobs you have as a new business owner is to determine the structure you want your business to take. How you structure your business will have an effect on costs, legal requirements, taxes, protection and responsibilities. All structures have advantages and disadvantages. Keep in mind that while you can always change your mind, some structures are easier to change than others. For example, it is relatively easy to move from being a sole proprietorship to becoming a corporation. Becoming a not-for-profit corporation takes a little longer and has additional requirements. Going from a not-for-profit to a for-profit corporation is also possible but comes with requirements that may prove challenging.

There are a number of choices to choose from:

- Sole proprietorship • Partnership
- Corporation
- Co-Operative

Sole Proprietorship

Sole proprietorship means exactly what it sounds like. You are the sole or only owner. This model means that you are responsible for everything that happens in the organization. All debts and profits are yours. Employees can be hired but you and your business are considered one entity under the law. This means your business income or loss is added or deducted from any other source of income, such as investments, on your personal tax return. If you have a loss it can also offset other income.

Advantages:

- You're the boss.
- The profits are yours.
- Very little money is required to get started.
- It's inexpensive to register.
- There are some tax advantages (if you are not profitable you offset your other income and your net taxable income goes down).
- There is little regulatory burden.

Disadvantages:

- Business claims can be made against you personally (unlimited liability).
- If you are profitable, the profit is added to your other personal income and your taxable income goes up.

- You are your business. When you are ill or unavailable, your business stops.
- No name protection exists.
- If an investment is required and you do not have appropriate staff support, you must seek it while continuing to run your business.

Partnerships

A partnership is like a sole proprietorship, but there is more than one owner. This usually means you have more working capital and resources, but it also means there are more opinions to manage. Profits are shared between partners depending on the agreement established. As noted above, the business income/ loss is reported on your personal tax return.

Before starting any partnership, make sure a written agreement is in place. The agreement helps to ensure that all parties understand what is expected of them and what they should be receiving in return. Without a legal agreement in place, you leave yourself open to potentially costly arguments. Use a lawyer to help you craft an agreement. This will help you to avoid mistakes and make sure that your interests are protected.

There are different types of partnerships: general partnership, limited partnership and limited liability partnership.

Advantages of Partnerships:

- Like a sole proprietorship, partnerships are fairly easy to establish.
- There are low start-up costs.
- You share costs.
- You have support in the management of the business.
- Tax advantage — if you are not profitable, the loss offsets other personal income and your taxable income goes down.

Disadvantages of Partnerships:

- You share in the profits and assets.
- There is no legal difference between you and your business.
- There is divided authority.
- It can be difficult to raise capital.
- Business claims can be made against you personally (unlimited liability).
- It can be difficult to find the right partner (skills, personality and financial).
- Between 70% and 80% of business partnerships fail as a consequence of conflict between partners.
- You are responsible for all business decisions made by your partner(s).
- If you are profitable, the net income is added to your personal taxable income.

Five Ways To Support Partnerships

No matter how old you are or how long you've known someone, partnerships work better when the rules of engagement are set out at the onset. The experts at The Balance suggest five ways to ensure your partnership runs well.

1. Have the same vision
2. Define business roles in advance
3. Avoid 50-50 splits (they lead to stalemates)
4. Hold a monthly partners meeting
5. Create a partnership agreement

Corporation

Incorporating a business essentially means that it is a separate legal entity. This can be done at either the federal or provincial/territorial levels. It is more costly to incorporate at the federal level, but it increases your business name protection if you want to do business across Canada. What this means is that your business can operate under the same name even if other companies with the same name are operating in a particular territory somewhere else in Canada. The name protection at the federal level is second only to trademark protection.

Incorporation means that if your business is sued or loses money you do not have as much legal liability for those debts. However, it best to seek legal counsel to understand what your liabilities are. A corporation can have many shareholders or just one. You might think about incorporation if you have significant personal assets that you want to protect or if you believe there may be a lawsuit pending. You may also consider this option if there are possible tax deferral strategies from which you can benefit.

Advantages:

- There is limited liability.
- Ownership is transferable.
- It's a separate legal entity.
- It's easier to raise money (corporations can sell stock).
- The corporation is taxed separately from the business owner and often corporate tax rates are less than personal tax rates.
- Ownership is transferable therefore the organization continues to exist even if the founder/principal leaves or dies (continuous existence).

Disadvantages:

- There is more regulation for a corporation.

- This is a much more complex structure which requires additional corporate records, including documentation that must be filed annually.
- This is a more expensive model to set up.
- Shareholders may be held legally responsible in some circumstances.
- Personal guarantees can undermine the limited liability advantages.

Non-profit Corporations and Organizations

Non-profits corporation (NPCs) or non-profit organizations (NPO) are similar entities. The difference is generally that an NPO is usually a charity, while an NPC is usually an association, school or church. A charity can become a not-for-profit corporation and the reverse is also possible. Being incorporated as a not-for-profit corporation is not enough for a corporation to be considered tax-exempt or a registered charity for the purposes of the Income Tax Act.

Charities describe a type of organization that is dedicated to supporting or furthering a particular social cause. To be considered a charity, there is a rigorous assessment and application process to be completed through the Canada Revenue Agency. For a broad understanding of what is required, the organization must have the following aims:

- Poverty relief
- Advancement of education
- Advancement of religion
- Certain other purposes that benefit the community in a way that the courts have said is charitable

Revenues for charities must go exclusively to the charitable purpose for which it was established.

A charity can:

- Issue tax receipts
- Receive donations from other charities
- Not pay income tax
- Be exempt from charging HST for many services
- Be eligible to claim tax rebates for HST paid

Not-for-profit corporations are generally corporations that have been created for purposes beyond making money. They can be charities but must apply for charitable status federally to benefit from tax exemption, etc. NCPs include, but are not limited to schools, churches, church associations, professional associations, sports associations, research institutes, museums or activity clubs. NPCs are created under federal or provincial law. In a non-profit corporation, any surplus in revenues is reinvested into the cause and is not distributed to the owners, shareholders, leaders or members.

Those who work for non-profits, other than volunteers, can receive a salary, but profits go towards fulfilling the objectives set out in the mission. Careful attention should be paid to federal and provincial requirements if you are considering establishing a charity or not-for-profit.

Benefit Corporations

A benefit corporation (B Corps) is a subset of corporations. They are different because they take into consideration other audiences, morals and mission in addition to making a profit. For example, they will follow B Lab verified standards in how they treat staff, customers and the environment. There is a certification process associated with the standing and in Canada, the B Lab provides this service. Certified B Corps are defined by the B Lab as “what Fair Trade certification is to coffee”. The central difference between a not-for-profit corporation and a B-Corp is ownership. A B-Corp is owned by shareholders while an NPC has no owners.

The B Lab is a non-profit organization that certifies businesses as not only being the best in the world but “being best for the world.” A Certified B Corp undergoes an assessment that verifies that all their business activities comply with the highest social and environmental standards and are publicly transparent and legally accountable.

B Corps are known to be financially and environmentally sustainable and of benefit to society. Currently, there are over a 150 B Corps in Canada.

Co-operatives

Co-operatives are corporations, but instead of shareholders, they have members. Members can be individuals or organizations. A cooperative can be a for-profit or not-for-profit. The members make decisions. All debts or profits are shared.

There are different types of co-operatives: consumer, producer, worker and a multi-stakeholder co-op.

Advantages:

- There's limited liability.
- Profits are shared among members.
- Each member has a vote.

Disadvantages:

- Just like partnerships, you can have arguments among members.
- To be successful all members must contribute.
- Decisions may take longer.

Social Enterprise

The legal structure of a social enterprise can be either for-profit or not-for-profit. A social enterprise can also become a B Corp. According to the government of Canada's website, a social enterprise "seeks to achieve social, cultural or environmental aims through the sale of goods and services". How revenue is disbursed by a social enterprise is dependent on the structure they adopt.

There are very mixed understandings of what social enterprises can mean. In some jurisdictions, social enterprises are the funding arm for non-profits. For example, a non-profit museum has a bookshop and all revenues go toward subsidizing the museum. Other definitions reflect the blended return on investment, both financial and social with all revenues being reinvested into the purpose as opposed to distributed to members or shareholders.

In Nova Scotia, other definitions are used to describe social enterprise as businesses that make a social, cultural and environmental change. The Centre for Social Enterprise Development suggests looking at why organizations exist rather than what they do to determine if they are a social enterprise.

Resources

- Benefit Corps: <http://www.bcorporation.net>
- Centre for Social Enterprise Development Ottawa <http://csedottawa.ca/>
- Sole Proprietorship, Partnership, Corporation or Co-operative?
<https://canadabusiness.ca/starting/before-starting-your-business/corporation-partnership-or-sole-proprietorship/F-S-N-A>
- Legal Issues for Small Business
<https://canadabusiness.ca/managing-your-business/day-to-day-operations/protecting-your-business/legal-issues/legal-issues-for-small-business/>
- An Information Guide on Co-operatives
http://www.ic.gc.ca/eic/site/693.nsf/eng/h_00073.html#what
- Federal: <https://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs04969.html>
- Provincial: <http://www.cbo-eco.ca/en/>
- Social Enterprise: <http://commongoodsolutions.ca/>