306-634-3895 | 403A 9th Ave, Estevan, SK, S4A2V4 | info@southeastbusinessstartup.ca

SOUTHEAST BUSINESS
START UP

BUSINESS STRUCTURES

There are several different ways to structure your business. Each of the structures have their own benefits and drawbacks. Here is some basic information on a few of the most common business structures but you should talk to your accountant and/or lawyer to determine which structure is best for you.

SOLE PROPRIETORSHIPS

A sole proprietorship is the simplest business structure. It is not its own legal entity and is just an extension of the owner. Most new businesses are sole proprietorships. Sole proprietors report their business income and expenses on their personal taxes and do not have to file separate income tax returns for their business.

Example: Helen opens a lemonade stand. She pays the business expenses with her bank account (it can be a separate account) and deposits the revenue in her bank account. She includes the revenue and expenses for the business under business income on her income tax return. Legally Helen is the business.

Pros

- Simplest structure
- Lowest set-up cost
- Very little paperwork needed
- Easy to file taxes
- If the business generates a loss, that loss can be applied to reduce income gained from other sources.

Cons

- Only allows 1 owner
- Proprietor is legally liable for the business (if the lemonade stand gets sued, Helen gets sued)
- Proprietor is financially liable for the business (if the lemonade stand owes money, Helen owes the money).

It is recommended that most small businesses start off as a sole proprietorship. Businesses can transition from sole proprietorships to corporations quite easily.

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PARTNERSHIPS

A partnership is similar to a sole proprietorship but there is more than one owner. A partnership is not its own legal entity and is just an extension of the owners. A partnership does not have to be between individuals, it can also be a partnership between 2 or more of other legal entities (eg. Corporations or trusts).

While not legally required, the partners in a partnership should always have a written contract setting out things such as shares of revenues, expenses, and workload. Each of the partners report their share of business income and expenses on their personal taxes and do not have to file separate income tax returns for their business.

Example: Helen and Frank decide to open a lemonade stand. They agree that Helen will make the lemonade and Frank will sell the lemonade. They agree that Helen will have a 60% share of the revenues and expenses and Frank will have a 40% share. Helen will pay for 60% of the expenses and get to keep 60% of the revenue. Frank will pay for 40% of the expenses and get to keep 40% of the revenue. They will each be responsible for the duties set out for them in their partnership agreement. Both Helen and Frank are legally and financially liable for the business.

Pros

- Simpler structure than a corporation
- Lower set-up cost than a corporation
- Allows multiple owners
- Easy to file taxes
- If the business generates a loss, that loss can be applied to reduce income gained from other sources.

Cons

- Partners are legally liable for the business (if the lemonade stand gets sued, both Helen and Frank get sued).
- Partners are financially liable for the business (if the lemonade stand owes money, both Helen and Frank owe the money).
- Partners can be legally and financially liable for the actions of the other partners (If Frank empties the bank account and flees the country Helen still has to pay the partnership's bills).
- It can be extremely difficult to resolve problems that are not covered in the partnership agreement.

A partnership has its uses, but it is extremely dangerous to enter a partnership with someone else even if you know them well and have a good contract. A partnership with someone you don't know well and/or without a good contract is a recipe for disaster.

CORPORATIONS

A corporation is its own person. It can enter into contracts and own property in its own name, separately and distinctly from its owners. A corporation issues shares to its shareholders in exchange for money, assets, work, etc. Shareholders get a vote on the direction of the company for each voting share they have and own a percentage of the corporation equal to the percentage of the common shares of the corporation they own (most shares in a corporation are common voting shares).

A corporation files its own tax returns and pays its own taxes. Corporations get money to their shareholders by issuing dividends.

Example: Helen, Frank, and Alice decide to start a corporation called Lemonade Inc. Helen buys 40 shares, Frank buys 35 shares, and Alice buys 25 shares (All common voting shares). Lemonade Inc. opens a lemonade stand. It has its own bank account and files its own taxes. Any profit Lemonade Inc. makes stays with the corporation until it pays dividends. Lemonade Inc. pays some taxes on its profits and Helen, Frank, and Alice pay some taxes on the dividends they receive. If Lemonade Inc. declares a dividend, Helen will get 40% of the dividend money, Frank will get 35%, and Alice will get 25%. If there is a vote then Helen gets 40 votes, Frank gets 35 votes, and Alice gets 25 votes. If Lemonade Inc. gets sued or goes bankrupt Helen, Frank, and Alice are not legally or financially liable unless they have done something else to become liable (like theft or fraud).

Pros

- Most flexible structure
- Makes it easier for people to invest in your business
- Allows multiple owners
- Easier for one person to sell their share of the business
- If the corporation reinvests its profits it can avoid paying a lot of taxes
- Shareholders are not generally financially or legally liable for the corporation

Cons

- Most expensive to set up
- Added expense to file taxes and annual returns
- Partners can be legally and financially liable for the actions of the other partners (If Frank empties the bank account and flees the country Helen still has to pay the partnership's bills).
- It can be extremely difficult to resolve problems that are not covered in the partnership agreement.

Because corporations are more costly to operate than sole proprietorships and partnerships, new businesses do not usually incorporate unless they plan to acquire capital through sale of shares or are particularly worried about liability. Companies usually do not incorporate until they generate more profit than the owners want to pay themselves in a year.