CELEBRATING $50M LOANS DISBURSED

Entrepreneur's Quick-Reference Guide on Business Legal Structures

What Business Structure is Best for Your Start-up?

This general-information guide is designed to assist you in understanding your options and requirements of business registration in different jurisdictions in Ontario. This information should not be used as a substitute for professional advice. If you have any questions, consult your lawyer or accountant on what legal structure is best suited for your business. Please also remember to visit the website of ServiceOntario for any updates on the fees or registration process.

There are three most common types of business structures:

1. Sole Proprietorship
2. Partnership
3. Corporation

Each type has its own purpose and presents advantages and disadvantages based on the cost and complexity of its formation, taxation, operating and reporting requirements, and the amount of risk that entrepreneurs are willing to take in terms of their personal liability.

In addition, there are also other options and specialized forms of business organization like Limited Liability Partnerships (LLPs), not-for-profit corporations, franchises, and several types of joint ventures. They are not discussed here.

Sole Proprietorship

"A sole proprietorship is an unincorporated business that is owned by one individual."

https://www.canada.ca/en/revenue-agency/services/tax/businesses/small-businesses-self-employed-income/setting-your-business/sole-proprietorship.html

It is the most basic form of business ownership where there is no legal distinction between the individual and the business.

The Sole Proprietor is not considered an employee of the business.

Formation

To set up a Sole Proprietorship, there are no formal requirements other than to register the business name. If an entrepreneur carries on business under his or her own name, then he or she does not need to register.

Registering a business refers to registering the name of a business under the Business Names Act (Ontario). Once registered, the business will receive a Master Business Licence which indicates its registration and expiry dates, as well as the Business Identification Number (BIN) used by the Ministry of Government Services to identify provincial business registration.

The Master Business Licence (MBL) allows individuals to operate a business under a name other than the individual's full name, to set-up a business bank account and open tax accounts. It also serves as proof of business registration required by financial institutions.

Formation

The MBL must be renewed every 5 years to remain active.

Registration / Renewal Fees:

- $60 online
- $80 by mail or in person.

Source: ServiceOntario https://www.ontario.ca/page/registering-your-business-name#section-0

In addition, depending on where the business is conducted, proprietors may be required to obtain certain industry- and location-specific permits or licenses. To find out what permits/licences your business requires, click here: https://services.bizpal-perle.ca/?lang=en&b=01

Liability

The Sole Proprietor has unlimited liability for any business debts or obligations. Because the business is not a separate legal entity, all business liabilities extend from the business to the owner. This means the proprietor's personal assets can be seized to discharge the liability.

It is essential for sole proprietors to consider adequate insurance coverage to protect their personal assets.

Taxation

The Sole Proprietor is considered self-employed and the business itself is not taxed separately.

Business income is reported on the Sole Proprietor's tax return and taxed at the personal tax rate of the individual.

Business losses can be deducted against any other income earned by the Sole Proprietor.

Please also see our guide "Taxation Issues for Aboriginal Individuals and Organizations."

Summary of Advantages of a Sole Proprietorship

- ease of formation and dissolution
- the least regulated form of business
- lower entry and exit costs
- simpler tax filing as the business itself is not taxed separately
- proprietor has full control over business operations and is entitled to all profits.

Summary of Disadvantages of a Sole Proprietorship

- unlimited personal liability for all business debts and obligations
- difficulty raising additional capital for business expansion
- lack of continuity.

Partnership – General or Limited

"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."

https://www.canada.ca/en/revenue-agency/services/tax/businesses/small-businesses-self-employed-income/setting-your-business/partnership.html

Partners are not paid a salary as they are considered to be self-employed and not the employees of the business.

There are two types of partnerships: general partnership and limited partnership.

General Partnership consists of two or more general partners who manage the business and share its profits/losses.

General partners act on behalf of the Partnership, and they can legally bind each other without prior approval.

Limited Partnership has two types of partners. In addition to General Partners (one or more) who manage the business on behalf of the Partnership, there are Limited Partners (one or more) who provide capital but have restricted management responsibilities.

1 There are also Limited Liability Partnerships (LLPs) that are usually limited to regulated professions, such as lawyers or accountants. This type of partnership is not discussed in this guide.

Formation

A General Partnership is a business structure created automatically when two or more people are joining together and combining resources and skills to jointly operate a business and share its profits and liabilities.

In other words, to establish a General Partnership, the partners are not required to file their General Partnership Agreement, and there are no further registration requirements other than to register the partnership's business name.

Source: ServiceOntario https://www.ontario.ca/page/registering-your-business-name#section-0

Once the partnership's business name is registered under the Business Names Act (Ontario), the General Partnership will receive a Master Business Licence which indicates its registration and expiry dates, as well as the Business Identification Number (BIN) used by the Ministry of Government Services to identify provincial business registration.

Formation

The Master Business Licence must be renewed every 5 years to remain active.

While there is no formal requirement to have a written Partnership Agreement for the General Partnership to exist and be governed by the Ontario Partnership Act (https://www.ontario.ca/laws/statute/90p05), it is advisable to draft such an agreement to set out rules for partners entering or leaving the business, the division of partnership responsibilities and allocation of business profits/ losses, each partner's contribution to the business, dispute resolution process, and other important matters.

If a Partnership Agreement exists, the partners allocate business profits/losses based on the ownership percentages specified in the agreement. In the absence of a General Partnership Agreement, profits and losses are distributed equally among the partners.

Registration / Renewal Fees:
$60 online
$80 by mail or in person.

Source: ServiceOntario https://www.ontario.ca/page/registering-your-business-name#section-0

Formation

Limited Partnerships are governed by Ontario Limited Partnership Act (https://www.ontario.ca/laws/statute/90l16) and other applicable laws, and this type of business structure requires more work to establish compared to Sole Proprietorships and General Partnerships.

First, to form a Limited Partnership in Ontario, the partners must file a Declaration Form 3https://www.forms.ssb.gov.on.ca/mbs/ssb/forms/ssbforms.nsf/GetAttachDocs/007-07191~4/$File/TXT_07191E.htm under the Limited Partnership Act.

Second, while having a partnership agreement is optional for General Partnerships, it is mandatory for Limited Partnerships.

Formation

It is also important to note that a General Partnership Agreement format is not suitable for use by a Limited Partnership, and it is usually recommended to obtain professional advice when drafting a Limited Partnership Agreement.

Once completed and filed, the Declaration Form 3 is effective for a period of five years after the date of filling.

Registration / Renewal Fees:

- $210.

Source: ServiceOntario https://www.ontario.ca/page/registering-your-business-name#section-0

Both General and Limited Partnerships may also require certain permits and licenses to operate. These requirements are based on the location of the business and industry specifics. To find out what permits/licences your business requires, click here: https://services.bizpal-perle.ca/?lang=en&b=01

Liability

In the context of private equity, the definition of a “General Partner” or a “Limited Partner” generally refers to liability. General Partners are “jointly and severally” liable for the Partnership’s debts, and Limited Partners have limited liabilities.

In other words, General Partners’ personal property may be seized if the partnership becomes insolvent, while Limited Partners are not personally liable for business debts, and their liability doesn’t go beyond their capital contribution to the partnership.

Taxation

A Partnership is not a separate taxable entity, and, therefore, it does not pay income tax on its operating profits.

Each partner (regardless of whether it is a general partner or a limited partner) reports their share of the partnership's net income on their individual tax return as a self-employment income taxed at the personal tax rate of the individual.

Similar to a sole proprietorship, business losses can be deducted against other sources of personal income earned by the partner.

Please also see our guide “Taxation Issues for Aboriginal Individuals and Organizations.”

Summary of Advantages of a Partnership

- relatively simple and inexpensive type of business to establish
- different partners bring to the partnership different experience, complementary backgrounds, skills, money, and other assets
- business is not treated or taxed as a separate legal entity
- greater ability to raise funds compared to a sole proprietorship , because two or more people are combining their financial resources to conduct business.

Additionally:

❖ <u>For General Partners</u>:

- partners make business decisions and play an active role in the company's daily operations.

❖ <u>For Limited Partners</u>:

- partners enjoy personal asset protection against the partnership’s debts and obligations.

Summary of Disadvantages of a Partnership

- possible difficulties in raising additional capital, whether from the partners themselves or by incurring additional debt.

- challenging aspects of profit-sharing and arriving at a fair profit-distribution formula, considering that some partners would bring in more capital, while others contribute more time and expertise.

- divided authority can delay the decision-making process and may occasionally lead to disagreement.

Additionally:

❖ For General Partners:

- each partner has unlimited personal liability for the Partnership's debts and obligations

- partner's personal assets are not protected against business obligations and liabilities if the Partnership becomes insolvent

- partners are bound to contracts signed by each other on behalf of the Partnership and take on all risk and liability for their partner's actions.

❖ For Limited Partners:

- no control over business operations.

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.”

https://www.canada.ca/en/revenue-agency/services/tax/businesses/small-businesses-self-employed-income/setting-your-business/corporation.html

Corporations are the most complex entities to form and operate as they must comply with more rules and regulations than sole proprietorships and partnerships.

The “owners” of the corporation are its shareholders, and their ownership is determined by the number of shares (units of ownership) they hold.

The shareholders' rights, privileges and obligations, the ownership of shares, and the information of how the corporation will be organized, managed and run is set out in a Shareholder’s Agreement.

The shareholders are generally not involved in business operations, instead, they elect the board of directors who hire management team and employees to run the business.

A Corporation has the ability to acquire rights, obligations and liabilities, and it has the capacity to sue or be sued, as would a natural person.

Formation

Setting up a Corporation is more complex than starting a sole proprietorship or partnership.

A company can be incorporated either federally or provincially.

For more information, click here: https://www.ontariobusinesscentral.ca/blog/what-are-the-differences-between-a-federal-and-ontario-corporation/

Registration procedures, regulatory requirements, and taxes vary from province to province. For further information on how to incorporate a business corporation in Ontario, please visit the website of ServiceOntario at: https://www.ontario.ca/page/incorporating-business-corporation.

When a new corporation in Ontario is incorporated, a Certificate of Incorporation is issued. It includes: the name of the corporation; the Ontario Corporation Number assigned to the corporation; the date that the company was incorporated; a statement certifying that the company is a corporation incorporated under the laws of the Province of Ontario.

The business name registration is required for corporations carrying on business under a name other than their corporate name.

Formation

Methods of incorporation in Ontario:
Electronically through service providers under contract with the Ministry of Government and Consumer Services.

For more information about service providers visit:

Cyberbahn
OnCorp Direct Inc.
ESC Corporate Services Ltd

- The Ministry’s fee to file Articles of Incorporation electronically is $300. The Service Providers charge an additional fee for the immediate online service they provide.

- By mail or in person. Ontario Government filling fee is $360. The following documentation must be submitted: Articles of Incorporation, Ontario-based NUANS (for a proposed name), other documents as required.

Formation

For further information, please visit the website of *ServiceOntario* at: https://www.ontario.ca/page/incorporating-business-corporation.

It is advisable that legal advice be sought when forming a corporation.

Similar to other types of business, corporations may require obtaining certain licences and permits to operate legally. These requirements depend on the location of the business and industry specifics.

To find out what permits/licences your business requires, click here: https://services.bizpal-perle.ca/?lang=en&b=01

Liability

Shareholders are generally not personally liable for debts and obligations incurred by the company, and they can't lose more than they personally invested in the business.

Taxation

Since a corporation is a separate legal entity distinct from its owners, it files a separate tax return. Corporations pay federal and provincial income taxes.

When a new corporation in Ontario is incorporated, the Business Number (BN) is assigned by Canada Revenue Agency (CRA) as a tax identifier for the corporation.

Corporation profits are subject to "double taxation", meaning that, upon distribution to shareholders, business income is taxed at the entity level and then at the individual level, although at a reduced tax rate.

Please also see our guide "Taxation Issues for Aboriginal Individuals and Organizations."

Summary of Advantages of a Corporation

- separate legal entity
- owners (i.e., shareholders) have protection from personal liability restricted to the amount of a personal investment in a corporation
- perpetual existence as a legal entity
- never requires re-registration or renewal
- can easier attract employees with specialized skills
- greater access to capital to support business growth.

Summary of Disadvantages of a Corporation

- cost and complexity of formation
- subject to many regulations and reporting requirements
- high level of governance and oversight
- most shareholders do not have enough power to influence the decision-making process
- prolonged decision-making when multiple shareholders or investors are involved
- double taxation of profits
- extensive record keeping
- personal guarantees can undermine limited liability advantage.