Choosing the Right Structure for your Business

Choosing the right type of structure for your business is a key decision that impacts how your business operates and transitions in retirement.

Whether you already own a business, are thinking of starting a business or buying an existing business, choosing the right business structure can have a major impact on the future success of the enterprise as well as your personal tax, financial and estate planning situation.

A range of factors should be considered including the nature of the business, where it's located, the number of people involved, tax considerations, potential exposure to liability and the company's financial requirements. As such, it is important to consult experienced legal, accounting and tax professionals. Professional advisors can help ensure that you are well informed of the legal and taxation issues that you may encounter and that you understand the personal and business implications of your decisions.

Sole Proprietorships

A sole proprietorship is the simplest form of a business organization and is often the most inexpensive to set up. This can be a good option for small enterprises as the business owner will have direct control over business decisions and receive all the profits. However, with this kind of structure, the business owner is legally responsible for the debts and obligations of the business. This is called “unlimited liability”, which means that both your business and personal assets may be subject to the claims of creditors.

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Partnerships

Partnerships can be relatively easy to set up and often have low start-up costs. A key advantage of having partners is that they generally bring additional sources of investment capital and provide a broader management base. However, finding suitable partners can be a challenge. A written partnership agreement, can help minimize potential conflict. In many cases it sets out the terms of the business, protects the interests of individual partners in the event of disagreement or dissolution of the business and generally defines how the partners will share the business profits. Personal liability for the business and the actions of the partners can differ, depending on the type of partnership. One partner’s decisions may be legally binding on the other partners.

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Corporations

Corporations are very common business structures. A corporation is a separate legal entity from its shareholders and has most of the legal characteristics of an individual. It can own property, incur legal liability, lend, borrow and carry on a business. There is a specific type of corporation called a Canadian-controlled private corporation (“CCPC”). This type of corporation must be controlled by individuals who are resident of Canada, and is not listed on an exchange. A CCPC may be eligible for the small business deduction and if it meets the criteria of a Small Business Corporation, upon disposition of the CCPC shares, the capital gains may be exempt from tax, up to a specified limit using the Lifetime Capital Gains Exemption (LCGE).

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Corporations also file an annual corporate tax return. If you are thinking of starting or investing in a corporation, there can be several advantages. It can provide greater business continuity as shares can be bought and sold without affecting the company’s continued operation. In addition, as an owner-manager and a shareholder, liability is generally limited to the corporation so personal assets are generally protected from the company’s creditors unless personal guarantees for loans to the corporation have been provided.

Legal advice should be obtained when setting up or acquiring an incorporated business. Corporations are more closely regulated than sole proprietorships or partnerships and may cost more to set up. Corporations are required to hold annual shareholder meetings, meet certain recordkeeping obligations and possibly comply with legislative requirements specific to the industry. This can mean more administrative, legal and accounting expenditures.

Table 1: Summary of considerations for each type of business structure

Structure	Sole proprietorship	Partnership	Corporation
Cost	Lowest cost option	Relatively low start-up costs	Higher set up and ongoing costs
Level of control	Direct personal control	Shared with partner(s)	Potentially shared with a number of other stakeholders, including shareholders and directors which are chosen by controlling shareholders
Legal liability	Unlimited personal liability	• General partners: full liability jointly shared between partners • Limited partners: liability limited to amount invested	Liability typically transferred to corporation depending on the type of corporation
Convenience	Easiest to set up and manage	Generally easy to set up and manage	More complex administrative requirements, including tax, legal and regulatory filings
Business continuity	Difficult due to reliance on single individual	Other partners can help ensure continuity	As a separate legal entity, a corporation can continue even when its original shareholders move on
Investment capital	Raising new capital can be difficult	Partners can bring investment capital	Shareholders can invest substantial new capital
Tax considerations	Taxed personally	Partner's share of profit/loss is taxed personally	• Corporation files own tax return • Tax advantages can include small business deduction, LCGE and income splitting • Remuneration for business owner (salary, dividends, bonus)

Considerations

Work with your TD advisor to review which structure is best suited at this stage of your business' life cycle.