

Should you incorporate your small business?

When a business is started, it can be structured as a proprietorship, partnership, or corporation.

PROPRIETORSHIP

A **sole proprietorship** is one person operating a business. The income of the business is taxed in the hands of the owner, at personal tax rates.

Advantages of proprietorship:

- Setting up business in the form of a proprietorship is simple and inexpensive.
- Proprietorships are less regulated than corporations, however, proprietorships are regulated by the provincial/territorial governments, and may have to be registered.

Disadvantages of a proprietorship:

- Unlimited liability. The proprietor is liable for all debts and liabilities of the business. If the business is sued, all the assets of the owner are at risk.
- If the business is profitable, it will usually be paying higher taxes than if it was incorporated.
- A proprietorship has a lack of permanence - if the owner dies, the net business assets pass to the heirs, but valuable leases and contracts may not.

PARTNERSHIP

A **partnership** is also an unincorporated business, similar to a proprietorship, except two or more entities are partners in the business. For partners who are individuals, partnership income is taxed at personal income tax rates.

Advantages of partnership:

- The setup costs of a partnership are low.
- A partnership is less regulated than a corporation. A partnership agreement should be drawn up to outline the terms of the partnership, what happens in the event of dissolution, and what happens in the event of disagreements among partners.

Disadvantages of a partnership:

- Unlimited liability. The partners are jointly liable for all debts and other liabilities of the business. If the business is sued, all the assets of the partners are at risk.
- Decisions must be made jointly.
- If the business is profitable, it will usually be paying higher taxes than if it was incorporated.
- The death or retirement of a partner will not end the partner's liability for debts and obligations of the partnership that were incurred prior to the death or retirement. Also, if a partner retires and does not make the retirement publicly known, he/she could still be held liable for obligations incurred after the retirement.

CORPORATION

A **corporation** is a separate legal entity, which is formed by application to either the federal or provincial government.

Advantages of incorporation:

- The liability of the shareholders is usually limited to the amount invested in their shares in the corporation. The personal assets of the shareholders are protected from lawsuits against the corporation.
- A much lower rate of federal tax due to the small business deduction.
- A \$750,000 capital gains deduction can be claimed on the sale of shares of a qualifying corporation.
- perception of permanence.
- estate planning flexibility.
- tax (probate) flexibility.
- Private Health Service Plans can be used to provide tax-free benefits to employees.

Disadvantages of incorporation:

- Incorporation is the business structure with the highest setup and administrative costs.
- Incorporation is a more complicated business structure.
- Business losses cannot be written off against other income of the owners (shareholders).
- More administrative work is required: annual reports and corporate tax returns.

Generally, the higher the net income of your small business, the more advantageous it is to incorporate.

Each type of business entity has its advantages and disadvantages. It is highly recommended to seek professional advice to assist in your decision-making, and in the setting up of your business structure.

Learn what you need to know about starting and running a business in Ontario.
Talk to Bill, Carly or Bob at 'Contact Us' @ pettittschwarz.com