Sole Proprietorship vs. Partnerships

There are three common ways of organizing a business: sole proprietorship, partnership, and corporation. Which one is best for your business depends on a number of factors. This article discusses the pros and cons of sole proprietorships and partnerships.

Sole Proprietorship

Sole proprietorships are the easiest and least expensive type of business structure to maintain. If you carry on business under your own name, you are actually carrying on business as a sole proprietorship. There are no formal registration requirements for a sole proprietorship unless it will be carrying on business under a name other than your own. In this case, you must register your business' name with the Ministry of Government Services.

Because there are very few formalities associated with a sole proprietorship, it is a very flexible business format that can quickly react to changing circumstances. There are no shareholders, directors, or partners that must be consulted when making various decisions. The consequence of this is that you, as the sole proprietor, are liable for all of the debts and liabilities of the business. If your business goes into debt, your personal assets can be seized to satisfy this debt.

One reason some people prefer to operate as a sole proprietor is because all income and losses are attributable to the individual. All of the business' income is meant to be reported on your personal tax return. Because of this, business losses can be used to offset any other gains you may have, resulting in a net tax savings. For example, if you are a start-up with lots of expenses, and maybe you are married to someone who is working, you can offset your expenses with their salary.

Entrepreneurs will likely want to avoid carrying on business as a sole proprietor when seeking outside financial support because you will be dealing with investors who will want to exchange money for equity in an incorporated business.

Partnerships

When two or more people carry on business together with a view to profit, the relationship is called a partnership. A partnership is similar to a sole proprietorship in that it is relatively inexpensive to set up and there are few legal formalities required to create it. Like a sole proprietorship, all of the assets and liabilities of the partnership flow through to the people. Tax is calculated as if the partnership was a separate legal entity, and then the income and losses flow through to the partners in the proportion of their ownership. If you own 30 per cent of the partnership, you will need to pay income tax on 30 per cent of the partnership's taxable income. Each partner can have their assets seized in satisfaction of the partnership's debts.

Of particular interest to entrepreneurs is the idea of a "limited partnership." A limited partnership is one in which there are 'general partners' and 'limited partners'. A general partner is liable for any of the debts of the business. The limited partners' liability is limited to the amount they have contributed or agreed to contribute. In this structure, you could bring someone on who shares in the profits of the business without being liable in the way that a general partner would be.

Buy-sell provisions, also known as shotgun clauses, are generally inserted in partnership agreements as an exit provision. One partner offers to purchase the shares of the other partner(s) at the offered price per share and the others then have the option to either sell their shares or purchase the offering partner's shares at the specified price.

Service type businesses may be drawn towards the partnership structure. Although, with the corporate tax rates as low as it is today, many lawyers or accountants would recommend against this structure, preferring incorporation.