THE RIGHT LEGAL STRUCTURE WILL HELP YOUR BUSINESS GROW
Peter Jensen

The demands of the law on a business are very important when the business goes through changes. During the pandemic, many small and mid-sized businesses have been through overwhelming changes. Many were forced to close or downsize, others have generated increased sales and growth, and there has been a spike in new small businesses. The legal issues facing small and mid-sized businesses impacted by the pandemic are considered in this two-article series, the first examining how a new small business can gain an advantage by selecting the appropriate legal structure, and the second exploring the legal issues facing businesses that have either grown or downsized during the pandemic.

The law impacts every stage of a business, and the appropriate legal structure gives new small businesses a solid foundation to build, operate, grow, and succeed. For first-time small business owners, understanding the options and deciding on the appropriate legal structure is vital and should be done as early as possible and identified in the business plan. There are three possible structures for a for-profit business: sole proprietorship, partnership, or corporation. Each has its advantages and disadvantages.

Sole Proprietorship: This is the simplest and least expensive legal structure and it is also the most risky. The business is owned by one individual and business revenue belongs to the owner. There are no required costs to set up a sole proprietorship, but it is beneficial to register your business (around $80). A similar cost applies to registering the operating name or domain name of your business. The downside of a sole proprietorship is risk – the business owner is personally liable for business losses and any legal actions against the business.

Partnership: This is the default legal structure when a business is owned by two or more people. It is simple and inexpensive to set up. Although not legally required, partners are strongly advised to prepare a “Partnership Agreement” outlining the partners’ responsibilities and the operation of the business. Include the Partnership Agreement as an appendix in the business plan. The downside of a partnership is risk – the partners are personally liable for business losses and any legal actions against the business. However, a *limited liability partnership* can limit the owners’ personal liability (barring negligent, fraud, or illegal conduct) for all but one partner. At least one partner must remain personally liable.

Corporation: This is the legal structure that minimizes financial and legal risks and maximizes financing potential. One or more individuals may own a corporation. Once incorporated, a corporation becomes its own legal entity. As a result, owners of a corporation are not personally liable for business losses or legal actions against the company (barring negligent, fraud, or illegal conduct). A corporation may raise funds by issuing shares and preparing a “Shareholders’ Agreement” outlining corporate governance. Since corporations are taxed at a lower rate than individuals, owners can reduce their taxable income by keeping revenue in the corporation. To operate within Ontario, businesses may incorporate provincially, or federally, permitting the business to operate throughout Canada. The downside is that it takes some time to set up a corporation, it costs approximately $1000 - $1500, and has annual filing requirements.

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