Types of Business Structures and Overview of a Corporation

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Introduction

This paper provides a general overview of business structures, including sole proprietorships, partnerships and trusts, with a primary focus on corporations. The features of each structure are described, along with some of the advantages and disadvantages of each.

The reasons for choosing one structure over another will depend on the individual circumstances of each business. Common considerations include liability concerns, management and ownership, and tax planning.

Types of Business Structures

Sole Proprietorships

A sole proprietorship is the simplest form of business structure. A sole proprietor is anyone who carries on business without taking the steps required to use another type of structure. In a sole proprietorship, a single individual owns all of the assets of the business personally. The individual is responsible personally for all of the debts and liabilities of the business. In a sole proprietorship, the individual makes all of the decisions related to the business. The business is not considered a separate legal entity from the individual, though it may operate under a trade name instead of the individual's name.

A sole proprietorship is a good structure for an individual who is just beginning their business as it requires very little, if any, setup to begin operating. Once the business develops, the individual may choose to convert to a different structure, as the needs of the business evolve.

Advantages of a Sole Proprietorship

- Simplest and least expensive type of structure to set up.
- No specific legislation governs their operation.
- A sole proprietorship may need to obtain a business license before carrying on business but apart from this, and potentially the requirement to register a trade name, no other steps are required to set up a sole proprietorship.
- The income earned by the business and losses accruing to the business are considered to be income and losses of the individual for income tax purposes. As such, business expenses can be deducted from the individual's personal income.
- Even though the business and the individual are the same legal entity, the business can still hire employees.

Disadvantages of a Sole Proprietorship

- Because the business is not a separate legal entity, the individual is fully liable for all of the debts and liabilities of the business.
- If the business needs to borrow money or obtain supplies on credit, the individual is ultimately responsible for the debts.
- If there is an accident or dispute that results in a lawsuit against the business, the individual is personally liable for any judgment against the business. This means that all of the individual's personal assets can be used to satisfy the judgment, even if they are not related to the business.
- The only means of raising funds to finance the business, other than the personal funds of the individual, is debt financing (i.e. borrowing money).
- If the individual dies, the business ends.
- The assets of the business may be sold to a third party but the individual remains liable for the obligations of the business which arose prior to the sale.

Because of the unlimited liability of the individual who operates as a sole proprietor, it is prudent for a sole proprietor to obtain some measure of insurance for their business operation.

Partnerships

A partnership occurs automatically as a matter of law when two or more people carry on a business with a view to profit. Each of these people is a partner in the business and owes every other partner a duty to act in the best interests of the partnership. Like a sole proprietorship, a partnership is not considered a separate legal entity.

The *Partnership Act* governs the rights and responsibilities of the partners in the partnership. A partnership can involve any number of people, including individuals and corporations, and may be created either by agreement amongst the parties or by their conduct. However, it is prudent to have a written partnership agreement which sets out the obligations of each partner vis-à-vis the other partners, as well as how any disputes or disagreements among the partners are to be resolved.

Advantages of a Partnership

- As a partnership involves two or more people acting together, they can pool their financial, managerial and technical resources.
- Partnerships are very flexible in terms of organization.