



Canadian Legal Guide for Small Business

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Self-Counsel Press
(a division of)
International Self-Counsel Press Ltd.
Canada USA



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Part I

Ways of Carrying On a Small Business

There are three ways for you to carry on a small business in Canada. You can operate as a sole proprietor. You can carry on business in partnership with another person (or persons). Or you can incorporate a company.

Each of these ways of doing business has advantages and disadvantages. The purpose of Part I is to help you determine which business form is best suited to meet your particular needs and expectations.



1

Sole Proprietorship

The simplest and least expensive way to carry on a small business in Canada is the sole proprietorship.

As its name implies, a sole proprietorship means one person in business for himself or herself. As a way of carrying on a small business, sole proprietorship has proven especially popular with students, homemakers, and people who are just starting up a business or are already employed full time in some other enterprise.

Typical examples of businesses that are sometimes conducted as sole proprietorships are —

- ✦ a student mowing lawns in his or her neighbourhood;
- ✦ an employed person who supplements his or her income by spending weekends making pizzas at home, freezing them, and then selling them to neighbourhood restaurants; and
- ✦ a house painter who does not necessarily require much equipment or overhead

and, for the most part, can do the job alone or with minimal help from others.

These examples share an important similarity, one that defines the very essence of a sole proprietorship; namely, as a sole proprietor, you are the business.

a. Setting Up a Sole Proprietorship

Because, as a sole proprietor, you are the business, no special legal steps are needed to set up a sole proprietorship. As soon as you do business for yourself — that is to say, as soon as you engage in some sort of commercial activity — you are doing business as a sole proprietor. Thus, the term “sole proprietorship” does not refer to any formal legal structure; it merely designates that you are involved in a commercial activity.

It is worth noting that you are nonetheless required to obtain licenses or permits to engage in certain types of commercial activity. For example, you may operate a plumbing business

as a sole proprietor; however, to do so legally, you must be licensed by the municipality in which you plan to carry on that business. (See Chapter 5, Licenses and Permits, for a further discussion of license and permit requirements relevant to your small business.)

As a sole proprietor, you may carry on business under a name other than your own. For example, a house painter by the name of Fred Green can, if he wishes, carry on business under the name “The Happy House Painter.” That means he can advertise to the public under that name, list his business in the telephone book under that name, enter into contracts as “The Happy House Painter,” and do anything else in connection with his business under that name that he can legally do under the name Fred Green.

Note, however, that anyone who carries on business under a name other than his or her own name is required to register that name with the relevant government authority. This is necessary to ensure that both the government and the public can determine who, in a given instance, is carrying on business under a particular business name. (See Chapter 4, Choosing a Business Name, for a further discussion of business name registration requirements.)

b. Advantages and Disadvantages

To determine whether you should operate your small business as a sole proprietorship, consider some of this structure’s advantages and disadvantages.

1. Advantages

There are several advantages to operating your small business as a sole proprietorship:

- (a) *You can start doing business right away.* You don’t need to do anything to set up a sole proprietorship. Your sole proprietorship is established when you begin whatever business activity you plan to carry on.
- (b) *It is inexpensive compared to other ways of carrying on a small business.* This is because no special legal steps need to be taken to conduct business as a sole proprietorship.
- (c) *Though most sole proprietors carry on business alone, a sole proprietorship can have employees.* Being able to hire employees means you can spread the workload among several people. This is useful if the job you do requires you to be in several places at once or for work that can’t be done by one person alone, such as moving furniture. An employee is also capable of filling in for you when you are sick or otherwise unable to work. (See Chapter 13, Employees, for a further discussion of employment matters.)
- (d) *All the benefits of the business belong to you personally.* That means the assets and income of the business are yours to do with as you please. For example, if you carry on business fixing small appliances in your basement on weekends, the tools you buy all belong to you personally. If you decide to stop doing business, the tools remain yours. As you will see, this is not necessarily the case with other business forms. In addition, any money you earn in your business becomes part of your personal income: your business profits are your profits.

- (e) *Business losses may reduce your personal income tax.* Because any income your business earns becomes part of your personal income, it is added to any other income you earn (for example, as an employee of another business) and taxed at the individual rate set under the federal Income Tax Act. Depending on your financial circumstances, this may not be an advantage. However, if your business creates losses — that is, if the costs you incur in your business exceed its revenue — those losses may be used to reduce your personal income tax and possibly place you in a lower tax bracket. (See Chapter 15, Taxes, for a further discussion of tax matters.)
- (f) *Because there is nothing involved in setting up a sole proprietorship, there is nothing involved in winding one down.* Your sole proprietorship ends when you stop doing whatever work you were performing as a sole proprietor.

2. Disadvantages

As you might expect, there are disadvantages to sole proprietorships:

- (a) *Just as the benefits of the business belong to you personally, so too do the obligations.* If, as “The Happy House Painter,” you have a telephone line installed in your basement, the cost of installation and any telephone bills become your personal obligations. That is because you are the business. Any debts or liabilities you incur in conducting your business are your debts and liabilities. As you can see, the knife cuts both ways.
 - (b) *Your liability for things you do in the course of operating your business is unlimited.* In other words, not only are the obligations of the business your obligations, but there is also no limit on the amount for which you may be obligated. Moreover, your business obligations can be satisfied by recourse to your personal assets. If you agree to paint someone’s living room and, while doing so, accidentally splash paint on their Renoir painting, not only are you obligated to repair or replace that Renoir but you may also be required to use your personal assets (e.g., dip into your savings account) to satisfy that obligation.
- The risk associated with unlimited liability is the single biggest deterrent to carrying on business in the form of a sole proprietorship. To avoid that risk, you must either incorporate a company and do business that way (see Chapter 3, Corporation) or procure adequate insurance against any possible mishaps. In some cases, your insurance coverage may be all that stands between you and personal bankruptcy (See Chapter 7, Insurance, for a further discussion of insurance matters affecting your small business.)
- (c) *Though you can employ others, you cannot employ yourself.* While employing oneself might seem a little strange, being able to employ oneself — as is possible when you carry on business in the form of a corporation — may result in tax savings.
 - (d) *In Canada (to the chagrin of many), individuals are taxed at progressively higher rates*

than corporations. A sole proprietor cannot take advantage of the more favourable tax treatment afforded incorporated businesses.

- (e) *The federal government and certain provincial governments have established grant and loan programs as well as other small-business assistance measures that often apply only to incorporated businesses.* Therefore, these programs are not available to sole proprietorships.
- (f) *Certain types of business arrangements will not allow you to carry on your small business as a sole proprietorship.* For example, if you want to carry on business as a franchisee of a pizza chain, it is likely that the franchisor will require you to incorporate a company in order to operate that franchise.
- (g) *There is a (misguided) perception that a sole proprietor may not be as serious about his or her business as is someone who does business in the form of a corporation.* This can raise problems where you require a loan from a bank or credit from a supplier.
- (h) *When you stop doing business, the sole proprietorship ceases.* It does not continue without you. The business cannot be passed on after you die, if that is your intention. That is not to say you cannot pass on the assets that make up the business, but it means that the person to whom the business is passed will have to start his or her own business with those assets or make them part of a business that he or she already operates.

c. Is a Sole Proprietorship Right for You?

The ideal candidates for carrying on a small business in the form of a sole proprietorship will have a special skill or talent that they wish to use in earning income. They will also be capable of running the business substantially on their own.

Checklist

If sole proprietorship seems right for you, before starting business, remember to do the following:

- ✓ Register any names under which you plan to carry on business.
- ✓ Obtain the necessary licenses and permits to legally allow you to do what you do.
- ✓ Obtain appropriate insurance coverage.

d. Summary

Many successful small businesses are run as sole proprietorships. In addition, many large businesses started out as sole proprietorships and were incorporated only after the business itself became too much for one person to handle. In short, sole proprietorship remains the basis of many a great entrepreneurial beginning.