



# For New Small Business Owners

---

## Things to Consider

### 1. WHAT FORM OF BUSINESS IS RIGHT FOR YOU?

#### **Sole Proprietorship**

A sole proprietorship is a business owned and operated by one individual. It is not considered to be a legal entity under the law, but rather is an extension of the individual who owns it and therefore does not require any specific legal organization, except of course, the normal requirements such as licenses or permits.

The owner has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. Any loans of the proprietorship are identical to personal loans of the individual. The income or loss of a sole proprietorship is combined with the other earnings of an individual for income tax purposes.

#### **Partnerships**

A partnership is a relationship between persons carrying on a profit-motivated business in common. That is, a defining characteristic of a partnership is that there must be more than one person involved in the business. Any number of individuals operating a business in common can establish a general partnership without any government approval. A general partnership is created by the partners and is routinely registered with the government within 60 days of creation. Registration is relatively easy and primarily involves paying a fee to the government. Determining and documenting the rights and obligations of the partners is much more involved. These rights, responsibilities and obligations are typically detailed in a partnership agreement. It is a good idea to have such an agreement for any partnership.

A partnership is a legal entity recognized under the law and as such it has rights and responsibilities in and of itself. A partnership can sign contracts, obtain trade credit and borrow money. Any partner is responsible for all liabilities of the partnership. Creditors often “go after” the wealthier partners first when the partnership does not pay its obligations. When a partnership is small creditors may require a personal guarantee of the partners before granting credit. A partnership does NOT have to file income tax returns or pay income tax. The financial information from the partnership is combined with the personal income of the partners to determine their overall tax liability. Partnerships with more than FIVE partners have to comply with Revenue Canada's reporting requirements.

## **Corporation**

A corporation is a separate legal entity which exists under the authority granted by either provincial or federal law. A corporation has substantially all of the legal rights of an individual and is responsible for its own debts. It must also file income tax returns and pay taxes on income it derives from its operations. Typically, the owners or shareholders of a corporation are protected from most of the liabilities of the business. However, when a corporation is small, creditors may and almost all banks will require personal guarantees of the principal owners before extending credit. The legal protection afforded the owners of a corporation can far outweigh the additional expense of starting and administering a corporation.

Corporations must file annual income tax returns with the Revenue Canada (federal) and the Ministry of Finance (provincial) and possibly other provinces in which it does business. Legal fees for incorporating commonly run from \$500 to \$1,000, and government fees, vary depending on provincial (\$315 in Ontario) or federal (\$500) incorporation.

## **2. SELECTING A COMPANY NAME**

### **Think Big**

If you are successful with your new business, your choice will be with you for a long time. Not only that, but it could also influence the growth of your business.

### **The Sound & Spell Test**

The last thing you'll want to hear from people after you've selected, registered and imprinted your business name on everything from business cards to signage is, “Huh? How do you spell that?” That's where our sound and spell test comes in. Here's how it works.

Example: Your business is a booming success. You've just booked 30-second radio spots on stations across the country. Your marketing team is working on a series of ads that will drive traffic to your [businessname.com](http://businessname.com).



The test: If someone were to say your business name over the radio, would people be able to remember it? Spell it correctly? Easily translate it into a properly spelled dotcom address for surfing at another time during the day? A good name is something that can be mentioned on the radio or over the phone, without a lot of explanation. A great name does this and is memorable.

### **Check out your Dotcom Options**

As the Internet reaches a critical mass, owning a good .com domain name has a tremendous value. If you believe the Internet will play an important role in the future of your business, you'll want to factor the availability of dotcom names into your name choice.

### **Tread Lightly on Trademark & other Legal Issues**

Just because you've found a name and it appears to be available, it does not mean that you are free to use it for your business. If your name conflicts with an existing trademark, tradename or someone's intellectual property, you could find yourself facing a lawsuit and the possible loss of your business name.

### **Conclusion**

Finding a name isn't always easy, but if you invest the time and effort, you should be able to come up with a great name for your new business. In the long run, this effort can add considerable value to your business

## **3. CHOOSING A YEAR-END**

All new sole proprietorships and partnerships must report their income on a calendar basis. This means using a December year-end for tax reporting purposes. You could have a non-December year-end for accounting purposes; however, the aggravation of having two sets of books (one for management and second for tax purposes) means it rarely makes sense to do so. Therefore, if you are starting a sole proprietorship or partnership, you'll have a December year-end. It will simplify your life.

A corporation can have any date as its year-end, but it must use the same date for each year thereafter. For tax reasons you would choose a July or August year-end because you can achieve tax deferral on paying a bonus out of the corporation in the following calendar year (e.g., bonus expensed in July 2007 year-end in corporation, but personally taxed in 2008 when paid in January 2008).

For business reasons you would choose a year-end when your inventory levels are at their lowest. You have to do an inventory count at year-end so if the level is at its lowest, the count will be easier. In the case of service companies, inventory count means calculating their work-in-progress (often referred to



as WIP). Further, ending inventory factors into the calculation of net income. A lower ending inventory means lower taxable income and you therefore defer taxes.

For accounting reasons, most accountants are extremely busy in January to April. If you have a December year-end you will be dealing with a busy accountant. If you deal with an accountant when they are not as busy (e.g., having a July year-end) you'll get better attention, quicker service and possibly better work.

#### 4. WHAT TAXES MUST I PAY?

Taxes are paid differently depending on the legal status of your business. Both sole proprietorships and partnerships report their net income on the owners' personal tax returns, while corporations file a corporate tax return.

**Sole proprietors** report their company's net business profit (or loss) under the Self-Employment Income section of their personal tax returns.

You must report the gross and net income for your business and file either a Statement of Business Activities or a Statement of Professional Activities form. The main difference between the two is that some professional activities may differ from other types of businesses activities.

**Partnerships** do not pay income tax or file a tax return. Instead each partner reports his or her share of the partnership's net income or loss. This applies whether you received your share of the income in cash or as a credit to a capital account in the partnership.

Partners also file either a Statement of Business Activities or a Statement of Professional Activities form.

**Corporations'** business transactions are entered into and conducted separately from its owners. It therefore pays tax on the income it generates and files its own income tax return.

Corporations use the T2 return form, even if the company has zero taxes payable as in the case of non-profit organizations, tax-exempt corporations and inactive corporations. For full explanation on the items on the T2 return, consult the T2 Corporation Income Tax Guide (T4012).

Corporate filings are complex and assistance from a tax professional is recommended.

