



LEGAL STRUCTURES FOR SMALL BUSINESS

INTRODUCTION

It is essential that you consider what legal structure you will adopt in the setting up of your business. The structural form of your business will influence, amongst other things:

- Your liability for debts.
- Legal procedures for dealing with other people.
- How you can sell your business, and at what price.

THERE ARE THREE BASIC STRUCTURES COMMONLY USED BY SMALL BUSINESSES:

- **Sole Proprietor/Sole Trader:**
Where only one person is the owner, trading in his/her own right.
- **Partnership:**
Where between 2 or more people are the owners of the business.
- **Company:**
Shareholders are the owners of the company, which is run by directors for the shareholders. Known as a private company if the company is not listed on the Stock Exchange. A company may be structured as a Trading Trust. There are other structural forms like co-operatives and public companies. It is up to you which form you choose, but you would be advised to discuss the choices with a professional such as an accountant or solicitor.

To make your options clearer, some of the advantages and disadvantages of each form are outlined here:

Business Structure	Advantages	Disadvantages
Single Proprietorship	<ul style="list-style-type: none"> • Least expensive form to organise • Greatest freedom from regulation • Owner in direct control • All profits to owner 	<ul style="list-style-type: none"> • Unlimited liability • Lack of continuity • Difficulties in raising capital
Partnership	<ul style="list-style-type: none"> • Ease of formation • Low start-up costs • Additional capital sources • Possible tax advantage • Broader management base 	<ul style="list-style-type: none"> • Unlimited liability • Lack of continuity • Divided authority • Hard to find suitable partners • Danger of one partner putting others into debt
Company	<ul style="list-style-type: none"> • Limited liability • Ownership is transferable • Continuous existence • Separate legal entity • A Trading Trust if established, may give flexibility in the distribution of income and assets 	<ul style="list-style-type: none"> • Closely regulated • Most expensive form to organise • Charter restrictions • More expensive for record keeping • Company rate of taxation

SOLE TRADER

As a sole proprietor, you are your own boss and you alone are responsible for:

- Your staff
- Supplies
- Contracts
- All debts
- All decisions

If independence is your main motive for going into business, this form will probably suit you well.

How to Set Up As a Sole Proprietorship

First, you have to find a name for your business. A sole proprietor carries on business either in his/her own name (for example: Jason Patterson). If you trade under your own name or a trading name you don't have to register it.

As a structural form a sole proprietorship is the most simple, in that:

- You have the authority.
- You take the profits.
- It costs you little to establish the business.
- The law has little influence on the legal structure, and
- If for some reason you have to cease business, the wind-up process costs nothing.

By now, you're probably wondering why everyone isn't a sole proprietor if it's really so simple.

So, just what are the disadvantages?

The major legal disadvantage is that you must accept unlimited liability for your business. This means that if Jason loses thousands of dollars through mismanagement or just bad luck, he is liable to make good the loss not only from his business funds but also from his personal assets.

If the business fails and you owe more money than you have, you will probably be declared bankrupt. If this happens, the business and all your private property is sold to pay your debts. This could be your house, your car, your prized stamp collection.

On the personal level, you alone will have to meet all the pressures of management. This can affect your health, family life and general well-being.

PARTNERSHIP

The partnership form of a business is also fairly simple. It is two or more people agreeing to share:

- Ownership
- Responsibilities
- Management, and hopefully
- Profits.

But do you really need a partner? Consider the following question. Have you enough capital, knowledge and experience to succeed by yourself? If you answer "no" then maybe you need partners:

- What contribution in funds and skills would they need to make?
- Would that type of person work well with you?
- Do you know where to get help to draw up a partnership agreement?

You can see from these questions that although the partnership is simple, the actual working out may not be. As far as the law is concerned you don't have to formally call yourselves partners. What matters is:

- The intentions of the people involved;
- How they share the profit; and
- Whether they act as agents for each other.

How to Become A Partner

The three main ingredients of a partnership under the law are that:

- A business must be carried on,
- It must be carried on by people with a common view (for example: Paul and Mary have to agree on their restaurant as a business)
- It must be carried on with a view to profits.

While a partnership can be created by an agreement that is either written or spoken, it is much safer for you and your partner(s) to have a written agreement drawn up by a solicitor.

This agreement should cover all points of your partnership, but particularly the following:

- Management responsibilities (the “who does what”)
- Capital contributions (the “who pays what” and how much)
- Division of profits
- Loans to partners
- What to do in the case of death or retirement
- Purchase of a deceased partner’s share
- Dissolution of the partnership.

The law places joint liability on all partners for business debts. This means that each partner must pay back debts on an equal basis. As with a sole proprietorship, the liability of each partner is unlimited, so they could lose their homes, cars and stamp collections.

In addition, partners are agents for each other. This means that you are jointly liable for each other’s actions in connection with the business. If your partner makes a foolish mistake then it is your foolish mistake too.

A partnership is very similar to a marriage, in that each partner has legal obligations to the other(s). Again the success of a partnership relies on the existence of trust and confidence between the partners. A partnership agreement may provide for a way out in case of disagreement. The most appropriate time to draw up the partnership agreement is before you commence the business operation when everyone is looking forward to the business venture and all the options for the venture are being explored.

You can see now, why a partnership structure is not quite as simple as sole proprietorship.

PRIVATE COMPANY LIMITED

Requires only 1 shareholder with no maximum number of shareholders. Decisions are made by voting. Where all share have equal voting rights then each shareholder’s voting power is proportional to the number of shares s/he owns - the more shares, the more votes. Many companies are thus effectively controlled by one person who has over half of the total shares - a technique used by business owners to keep individual control but to use the limited liability structure.

By law, a limited liability company is a separate entity from the shareholders that formed it. Therefore if the company incurs debts which it cannot pay, those who are owed money may not be able to pursue the shareholders to recover the monies owed them.

This is because the liability of the company is limited to the amount they have purchased in shares. If the company has financial problems and is unable to pay its debts, the money that shareholders invested in shares will also be lost - but this is all the financial responsibility that the shareholders will have.

In recent years, however, some banks and other lenders have started to ask for “personal guarantees” from shareholders or directors before they will local a company money. This way, if the company can’t pay the loan, the shareholders or directors are obligated to - even if it means selling their private belongings to raise the money.