

Business Ownership - Sole Proprietorship and Partnership

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One of the first steps you'll need to take in establishing your home business is deciding on its legal structure. Legal structure means a lot more than you might think, it has serious consequences with regards to ownership, responsibility and liability. Unless you're in the know and have previous experience it's a good idea to consult an accountant or lawyer before deciding on the legal structure for your business.

The two most common legal structures to consider for your home business are sole proprietorship and partnership.

1.) Sole Proprietorship

A sole proprietorship is a single person business; it's the most common form of small business. As a work from home entrepreneur this will likely be your legal structure of choice. The same person who owns such a business is usually responsible for day to day operations and management. The sole proprietor owns all the assets of the business and in turn receives all of the profits it generates. On the down side there is no legal distinction between the business and the owner they are a single legal entity. This means that should the business run into trouble the owner has unlimited liability.

Advantages and disadvantages of this type of ownership:

Advantages

- Easy and affordable to setup and run, not much paper work required
- The owner has all the ownership and control
- All profits generated by the business belong to the owner
- No distinction between personal and business income means far tax complications
- If things don't work out the business is easy and inexpensive to terminate

Disadvantages

- You and your business are a single legal entity, this means you have unlimited liability. There is no difference for instance between your companies debt and your personal debt
- Loans are often very difficult to get, ideally a sole proprietor won't use debt financing
- Because you and the business are one entity the business can't be sold or transferred to another owner and dies when you die

2.) Partnership

A partnership is very similar to a sole proprietorship, instead of a single owner there are two or more owners. There is no legal distinction between the partners and the business, they are a single legal entity. It's almost impossible to establish rules and procedures after a dispute has already broken out make sure your contract at least covers the following points:

- Ownership and profit sharing
- Admittance of new partners and buying out of old partners
- Dispute mechanisms
- Rules for breaking up the partnership

Advantages and disadvantages of this type of ownership:

Advantages

- As with a sole proprietorship a partnership is easy and affordable to setup and run, however a well written contract is essential
- Partners can raise more start-up capital than a sole proprietor; this means more costly and possibly more lucrative business ideas can be attempted
- Partners also share knowledge, expertise and management responsibility
- It's possible to attract motivated employees with the incentive to become a partner
- No distinction between personal and business income means far tax complications

Disadvantages

- No legal distinction between the owners and the business means unlimited liability for the owners, there is also unlimited liability between owners
- When you're on your own there are no arguments to be had, working with partners mean disagreements can occur
- Breaking up a partnership can be very messy unless your contract is crystal clear on every possible eventuality

There are three different forms of partnership agreements

1.) General Partnership

Partners in a general partnership share profits and responsibility equally or according to an internal agreement.

2.) Limited Partnership

A limited partner has both general partners, defined above and limited partners. A limited partner has limited liability with regards to their management input and investment. General partners run and manage the company on a day to day basis. The purpose of the limited partnership agreement is to encourage silent partners who act as investors in the company.

3.) Joint Venture

This form of ownership is the same as a general partnership but only valid for a limited time period. Joint ventures are usually used for single projects between entrepreneurs. Once two entrepreneurs repeatedly form joint ventures they will have to form a formal general partnership.