Queen's Law Clinics
Business Law Clinic

Business Law Playbooks

Part 2 – Sole Proprietorships

Prepared by the Queen's Business Law Clinic in collaboration with Queen's Partnerships and Innovation

Table of Contents

About Queen's Partnerships and Innovation

Queen's Partnerships and Innovation ("QPI") aims to advance research, innovation, and knowledge mobilization to strengthen Queen's local, national, and global impact. QPI provides faculty, students, post-doctoral fellows, and other members of the Queen's community with a variety of services and resources to facilitate strategic initiatives and research partnerships. QPI is also proud to work with external organizations (both industry and not-for-profits) to connect them with expertise, resources, and incubation support.

About Queen's Business Law Clinic

The Queen's Business Law Clinic ("QBLC") is a free legal clinic which was established in 2009 to provide year-round legal services to a wide variety of individuals, businesses and non-for-profit organizations in southeastern Ontario. The QBLC aims to help individuals and businesses who would otherwise have difficulty affording legal counsel, while providing Queen's Law students with practical legal experience working with clients, while instilling in them the values of community service and the pro bono tradition. The QBLC is proud to have contributed to the economic growth and social well-being of Kingston and its surrounding communities by helping entrepreneurs, small businesses, charities and not-for-profit organizations with their legal needs.

Why do you need a Playbook?

For many people with little or no previous business or entrepreneurial experience, understanding the relationship between law and business – and how it may affect the success or failure of their business idea – is a very important step. In this series of Playbooks, we seek to provide general information on the legal concepts that should be considered by the entrepreneur starting out their business venture.

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2 Sole Proprietorships

2.1. How is a Sole Proprietorship Formed?

A sole proprietorship is an unincorporated business formed by an individual who has chosen to produce goods or offer services to the general public, in exchange for money, and with a view to make a profit. There are no formalities involved in the creation of a sole proprietorship, making it one of the easiest and simplest forms of carrying on business in Ontario and Canada. All that is required of the business owner is to register a trade name, obtain a tax number, and open a bank account. Many small businesses are faced with the decision of whether to incorporate at the outset, or whether to start operations as a sole proprietorship or a partnership and incorporate later. Unlike partnerships and corporations, which are governed by specific legislations pertaining to the business structure, sole proprietorships are not. We will be examining some of the factors to be considered when making that decision in this Playbook.

2.2. Features of a Sole Proprietorship

A sole proprietorship is, by nature, informal. It is the easiest and least expensive form of business to set up and operate. You may choose to carry on business as a sole proprietor under your personal name or register a business name. Unlike a partnership or corporation, there is no distinction between the business and its owner in a sole proprietorship. This means that the owner is personally responsible for any debts or liabilities incurred by the business and retains all profits made by the business. You own 100% of your business and have all the decision-making powers. You are basically the master of your own ship. Your tax obligations are relatively simple – no separate business tax return is required to be filed with the Canada Revenue Agency ("CRA"), as all income generated from the business is reported on your personal tax returns. This also means that you are able to deduct all expenses relating to the business from your personal income. For a start-up business that is losing money in the early years, this option of deducting business losses can help reduce the tax payable. Some expenses that may qualify as business expenses include travel expenses, advertising, and the cost of equipment. If your business is home-based, additional costs like a portion of your rent or mortgage payments, phone, internet and utility bills could also be deducted on your taxes.

Examples of businesses that can start operations as a sole proprietorship include landscaping, catering, accounting/tax preparation, legal, computer/IT, graphic design, event planning photography and consulting services, along with fitness instructors, motivational speakers and manufacturers. Please note that some of these activities may have additional statutory or regulatory requirements or may be better suited for another business structure depending on the potential liability that may flow from its operations. The QBLC recommends that you seek legal counsel before beginning a business.

2.3. Sole Proprietorship vs Partnership

Partnerships and sole proprietorships share many commonalities, as a partnership is essentially a sole proprietorship with multiple proprietors. A partnership is a relationship between two or more people carrying on a business together with a view to profit. This is very similar to the definition of a sole proprietorship. Both are business structures that are without legal personality, and the use of a name other than the names of the partners must be registered in accordance with the *Business Names Act* ("*BNA*"). Any gains or losses "flow through" the partnership and are represented on the partner's personal income tax. The differences between the two business vehicles are the result of having multiple proprietors and the relationship between them. A sole proprietorship, as a single person, does not have to concern themselves with any other party's actions. For more information about the partnership business structure, please refer to the "Partnerships" Playbook.

2.4. Sole Proprietorship vs Incorporation

Unlike sole proprietorships and partnerships, incorporation is a highly formal process. The process of incorporation (literally meaning "to give a body") creates a new legal person. The fact that a corporation has its own legal personality comes with many implications for your business. As a legal person, a corporation can own its own property, retain its earnings, and enter contracts in its own name. Most importantly, it creates a separation between the business and its shareholders. Shareholders have no direct claim to any of the business' property or earnings, but also are not liable for any of the business' liabilities. For example, if a corporation takes on a loan but goes bankrupt, the shareholders cannot be compelled to pay the outstanding balance on the loan.

Unlike a corporation, with its separate legal entity and perpetual existence, a sole proprietorship is no more than the person. This means the business cannot be transferred, and if the sole proprietor dies, so does the business. The founders of a corporation can pass away, and the corporation itself remains fully functional and able to conduct business. Meanwhile, shares of a corporation can be transferred like property, subject to any transfer restrictions that might be attached to the shares.

While sole proprietorships have no setup and maintenance requirements, corporations have a variety of requirements they need to fulfil. There is a fee to incorporating, and annual returns are required by the government. There are ongoing statutory obligations, like annual shareholder meeting and maintaining a corporate minute book. If the corporation continues to grow and attract investors, securities legislation and disclosure obligations may become important.

While the business' profits or losses are claimed on the sole proprietor's personal taxes, corporations file taxes on their own behalf, paying the corporate income tax rate. Corporations also distribute their profits as dividends, which are then taxed as the recipients of the income. This is sometimes referred to as "double taxation".

Lastly, it may be difficult to secure financing from a bank to fund a sole proprietorship because any debt borrowed will be considered as a personal loan. On the other hand, corporations can raise capital through equity financing. Equity financing is the issuance of shares in the corporation for money or other capital. Unlike debt financing, equity financing doesn't need to be repaid, but instead grants the shareholders some control over the corporation.

2.5. Operating Under Your Own Name as a Sole Proprietorship

If you operate under your own full, legal name, you are not required to register a name in Ontario, nor are you bound by any of the regulations in the *BNA*.

2.6. Registering a Business Name as a Sole Proprietorship in Ontario

Operating a sole proprietorship in any name that is not your own requires a registration of the business name. In Ontario, the rules for naming a business are governed by the *BNA*. The registration of a business name requires a registry search to ensure that no other names are similar to your proposed name. After registration, names in Ontario must also be renewed every five years. Each step of this process has an associated fee.

2.7. Trademarks Considerations

Before selecting a name for your sole proprietorship, or any other business vehicle, consider your ability to trademark your name. A trademark is a way for the public to identify that the goods or services being provided are from a certain party. Considering trademarks early in the business process goes a long way in protecting your business' reputation, as well as protecting against potential trademark infringement claims.

Trademarks include words, names, logos, designs or other traits like a certain colour that distinguishes the goods or services of that person from any other similar goods or services. These trademarks can be registered or unregistered. Registered trademarks are governed by the *Trade-marks Act* and are maintained by the Canadian Intellectual Property Office.

Unregistered trademarks are those that are protected at common law, and are protected by the tort (civil wrong) of "passing off". The claimant for an infringement of an unregistered trademark can show their name is associated with a set of products and a reputation within a certain geographical area, and if your name is found to be infringing on an unregistered trademark, you may be forced to change your name or be prohibited from conducting business in a certain geographical region.

The test for trademark infringement is whether a reasonable consumer, acting in a bit of a hurry, would mistake a good or service as being provided by another party. We recommend conducting a search of registered and unregistered trademarks before deciding on a business name. The QBLC can assist you in drafting an opinion on the eligibility for your name and logo for its ability to be filed as a registered trademark.

2.8. Steps to Set Up a Sole Proprietorship

2.8.1. Step 1: Decide on a Business Structure

Decide on the appropriate business structure – get legal and accounting advice from experts

2.8.2. Step 2: Choose a Business Name

Decide whether to use your personal name or choose a business name. If choosing a business name, you must register under the *BNA*. You must conduct a search through the Ontario Business

Registry to find out whether your proposed name is available. The cost to conduct a search may vary depending on the type of search records requested. Please contact the QBLC for assistance if you seek to conduct a name search for your sole proprietorship.

If your chosen name is available, register your business name in Ontario. You must register a business name if your chosen business name is different from your full name. Business name registration is effective for 5 years, after which you must renew it. The cost of registration of your business name might vary depending on your method of filing. Payment can be made online using a Visa or MasterCard, by mailing a cheque or money order to the Minister of Finance or by cash. Please contact the QBLC if you are seeking help in registering a business name in Ontario.

2.8.3. Step 3: Receive a Master Business Licence

If you registered a name, you should expect to receive your Master Business Licence by mail within 20 business days.

2.8.4. Step 4: Protect Your Intellectual Property

Protect your trademark. Register your trademark and purchase a domain using your preferred business name. Even if you are not yet ready to build your website, you will save yourself some trouble by reserving your domain name so that it is not taken up by another entity before you are ready to use it. The QBLC offers its clients trademarks advice by assisting them in conducting detailed trademark searches and providing them with a legal opinion on the availability of their proposed trademarks for registration in Canada.

2.9. Conclusion

There are good reasons to operate your business as a sole proprietorship. There are no formalities before getting started and you have absolute control over the business. However, there are also drawbacks like unlimited personal liability.

Choosing the optimal business vehicle from the outset will save you time, money, and energy which you can put towards growing your business instead. Make sure you consult legal, accounting, and tax professionals before you decide on the appropriate business structure.