WHAT IS THE BEST STRUCTURE FOR A BUSINESS?

To Incorporate or Not to Incorporate

By David Choo

Besides summoning the courage to follow their gut instincts and go it alone, budding entrepreneurs also have to choose the right form of business – sole proprietor, partnership or private limited company?

It's quick, simple and relatively cheap to establish a sole proprietorship or partnership. Just choose a name, go to the Registrar of Business, sign up and pay a small fee and you are in business. If you have what it takes – the capital, the expertise, the human resources and so on – and you are not involved in a risky endeavour fraught with potential liabilities, proprietorship and partnership are probably suitable.

But consider their greatest drawback – the unlimited liability of the business owners for any debts owed by the business. The enterprise and the owner are considered one and the same, and this unity means that the proprietorship is not a separate entity from the proprietor. The proprietor owns the business assets and is subject to liabilities without limit.

The same logic applies to a partnership, which is not a separate legal entity from its partners, who are jointly responsible for the liabilities of the business. This unlimited liability exposure should be of great concern, especially when one considers that the actions of one partner are binding on all the others.

RISKS? WHAT RISKS?

Whatever your line of business, you are exposed to potential risks and liabilities. Despite your best efforts, your business might fail. You could also be held liable for negligence, libel, or for dispensing the wrong advice. Your business might cause damage or injury to others or their property, or you may be held responsible for public liability, causing death or injury to a third party involved in the business. Employers can be held liable under the Workmen's Compensation Act or indeed under common law, and what happens if your products inadvertently cause death or injury to one of your customers?

With so many questions to answer, it's

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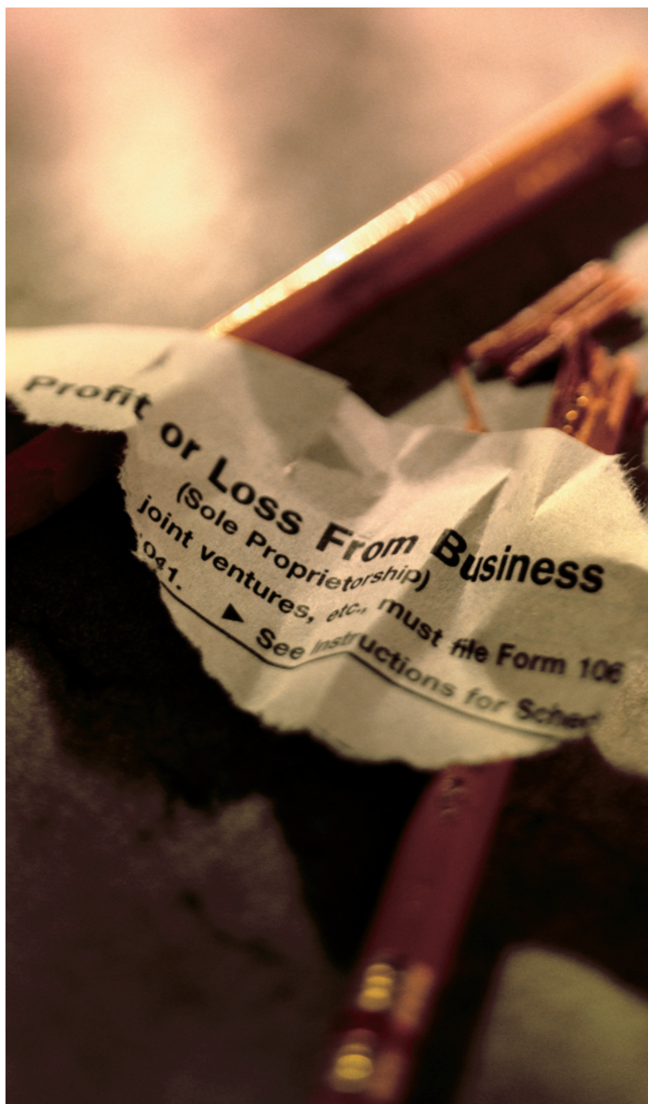

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ASKING THE RIGHT QUESTIONS

The Global Entrepreneurship Monitor's 2002 survey revealed that seven out of 10 working Singaporeans believe they do not have the skills needed to set up their own business, but those who do will sooner or later face the important decision of whether or not to incorporate it.

Aside from the issue of risk and liability, the decision will rest on a number of factors, beginning with the nature of the business. How much capital are you likely to require now and in the future? What level of expertise will you require, and how easy will it be to recruit employees?

It is also important to consider the tax implications, your licensing requirements (if any), and how easy it is to set up or dissolve a company. And don't forget to take into account how your clients are likely to perceive the different forms a business can take, not to mention the banks, which you may need to go to for credit.

sensible to carry out a risk audit and implement proper risk-management measures. You cannot insure against the risk of business failure, but other potential liabilities can be insured against. What stops most business owners from doing so is often a combination of complacency and an unawareness of the risks involved, but the recent Slim 10 episode should have opened everyone's eyes to the heavy financial consequences that can result from liability claims. Food (and especially health food) businesses are fraught with product liability risk, so to avoid going out of business unexpectedly and running the risk of bankruptcy, business owners should try to manage their risk.

SUCCESSION ISSUES

Another important concern that is often glossed over is the issue of business continuity. A company can carry on despite the death of a major shareholder because it stands as a separate legal entity, but unless certain steps are taken the same does not apply to a proprietorship or partnership.

Engrossed in day-to-day business demands, most owners neglect long-term planning and do little to prepare for eventualities like their death or disability. It is, however, crucial to ask yourself a series of simple questions. How will your business survive without you and who will inherit it? Will your children fight over it, and will key people stay on?

Sole proprietors need to address these issues, but these questions are actually more pressing for the people involved in a thriving partnership. You have a capable partner. The business is cruising along smoothly, and both of you are enjoying a good net income. But do you know what will happen when your partner dies?

According to the law, a partnership cannot survive any one of its owners, so the partnership may have to be dissolved. To keep the business going might mean paying the beneficiaries of your deceased partner for what is now their share, unless other arrangements have been made. Do you have enough ready cash to pay off this amount, and how are you going to agree on the value?

Many of these issues can be solved by proper succession planning and such strategies as making a will, the power of attorney, buy and sell agreements, trust and 'keyman' insurance. An adviser who is familiar with business-succession planning would be able to explain these strategies and structure a good plan. This is not a run-of-the-mill matter and only someone familiar with legal, taxation and business practices would be able to handle it completely.

KEEP SAVING

Another area of concern is the business owner's retirement needs. While employees make compulsory contributions to their CPF accounts and build their retirement nest eggs, a business owner who is only required to contribute to Medisave may neglect his own retirement fund.

Business owners are often pressed for cash in the build-up years and view voluntary CPF contributions as tying up much-needed resources, but business owners who are able to should consider contributing either to the CPF or Supplementary Retirement Scheme (SRS), or both.

There are tax advantages to be gained by doing so, including a tax deduction for the amount contributed to the CPF (up to the prevailing limit), which can lead to savings on personal tax of a few thousand dollars. The same goes for money contributed to the SRS each year, too, but note the 5% penalty on SRS withdrawals before the age of 62, and the 50% taxable-income rule on withdrawals after.

Business owners should continually be considering the advantages of incorporation in terms of business continuity, limited liability and taxes. More and more medical and law practices, for example, are beginning to do this. Business owners should be able to enjoy the fruits of their labour and to see their thriving business managed by people they are happy with. Keeping things in the family is not necessarily the best choice – the important thing is what's best for the businessman, his family and the business. **si**

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