The legal features of sole proprietorship, partnership and corporation

The Legal Features of Sole Proprietorship, Partnership and Corporation Submitted by: Darius Immanuel D. Guerrero BAP 3A February 28, 2012 Sole Proprietorship A sole proprietorship is a business entity that is totally inseparable from its single owner. The law treats the business and the owner as the same. Because of this, all liabilities are taken for the owner. The owner does not pay income tax separately for the business, but reports the business income or losses on his/her individual income tax return.

In order to start a sole proprietorship, one must be at least eighteen years old. To start with, the minimum requirements need to be fulfilled. The person must visit the DTI Business Registration System (BNRS) to register the name of the business. If unavailable, must call the number 751-3330 to contact DTI Direct. The transaction reference number acknowledgement email will be sent to the applicant. With all the supporting documents, one must proceed to the DTI office.

The documents are plentiful. One must acquire a certificate of business name registration from the DTI. One must also have a certificate of registration from the local BIR Revenue District Office or RDO. A mayor’s permit from city hall and a barangay clearance from the local barangay hall is also needed. A SS number as an employer or as self-employed must be acquired from an SSS branch. A Philhealth is also needed. The other things needed are: original & photocopy of proof of citizenship (e. g.

PRC ID, birth certificate, voters ID, passport); signed copy of undertaking from DTI BNRS; payment of P300 for application (+P15 for documentary stamps); 2 recent identical passport size picture (with signature of owner at

the back). For franchise holders, a photocopy of franchise agreement, each page duly certified by the franchisor or franchisee and a photocopy of Business Name Certificate of franchisor is also needed. The DTI registration has to be renewed every year, with a renewal fee of three hundred pesos.

If the renewal is made after ninety days from expiration, there is a surcharge of one hundred pesos. Unlike corporations, there is a limit to the amount and number of deductions allowed. The sole proprietor is similar with the regular tax payer. The main difference between them is that the sole proprietor must list the business's profit or loss information. There will be tax on all profits of the business, which is total income minus the expenses. Because the sole proprietor is self-employed, it is his job to withhold income taxes from the pay check.

The tax rates for an individual and proprietor are the same. The rates are: Not over P10, 000 = 5% Over P10, 000 but not over P30, 000 = P500+10% of the excess over P10, 000 Over P30, 000 but not over P70, 000 = P2, 500+15% of the excess over P30, 000 Over P70, 000 but not over P140, 000 = P8, 500+20% of the excess over P70, 000 Over P140, 000 but not over P250, 000 = P22, 500+25% of the excess over P140, 000 Over P250, 000 but not over P500, 000 = P50, 000+30% of the excess over P250, 000 Over P500, 000 = P125, 000+34% of the excess over P500, 000 There are special exemptions for sole proprietor.

He must indicate whether to choose optional deduction, which does not exceed 40% of the net sales, or itemized deduction which contains business expenses, taxes, losses, bad debts, depreciation, depletion, charitable

contributions, research and pension trusts. In addition to these, the sole proprietor can avail of the regular personal exemptions that tax payers have. For single individuals, there is a Php 50, 000 personal exemption. For married individual and head of the family, it is also Php 50, 000 but each qualified dependent will allow that individual Php 25, 000.

There will only be exemptions for up to four individuals. There are also additional exemptions for husbands who are deemed head of the family, a spouse who is in custody of a child in cases of legally separated spouses, or a head of the family supporting a qualified dependent. The total amount of additional exemptions shall not exceed the limitations allowed by the Tax Code. Partnership A partnership is an unincorporated business which two or more individuals manage the business and are equally liable for its debts.

The partnership does not pay for the income taxes, but each partner has to report their share of business profits on their individual tax return. They are a flow-through entity or pass-through entity which means that the taxes are computed based on the entity's gross income but are taxed on the partners. This also means that it does not provide the protection that a corporation does. If a partnership has made a bad deal or has failed to pay its debts, the partners can lose their property. The partners themselves can also be sued.

If a partner leaves the partnership, the business dissolves. The procedure to start a partnership is similar to that of a sole proprietorship but must also go to register the business partnership is with the SEC or Securities and Exchange Commission. There must be at least two applicants, with the majority of the applicants being residents of the Philippines. This agency will

issue a certification of the partnership. There are requirements necessary for the certificate of registration to be fulfilled. First is the name verification slip, which must contain the name of the business.

Next, the articles of partnership is needed, which must contain the agreement between the partners, how much of the capitals and losses are to be shared among the individuals. There should also be a registration data sheet, endorsement clearances from other government agencies, and a bank certificate on the capital contribution of the partners. If there are foreign partners, Application Form F-105 and a proof of remittance from the foreign partners is required. The SEC certificate will then be submitted to the BIR for the issuance of a TIN or Tax Identification Number.

The taxable income of a partnership is the same as that of the corporation. The allocation of burden and profits is proportionate to how much each partner has contributed. For example: Mr. Betita has 55% while Darius has 45% of a partnership. This means that Mr. Betita is entitled to 55% of the profits and losses while Darius is entitled to 45% of them. If the partners do not want to share proportionately to how much their percentage interest is, it is called special allocation. However, the special allocation must adhere to the rules of the Philippine Tax Code. For the tax rates, each partner ust report their distributive share as gross income. They will only be liable for income tax in their separate and individual capacities. The law treats each partner as if though he or she has received the profits, therefore, each partner must pay for the profits regardless they actually receive their share or not. Establishing a partnership would mean tax deduction for each partner. Each partner only pay the capital gains tax depending on how much

they have given for the business. Each partner can also write off their capital loss in their personal tax returns.

They can also write off interest payments as a necessary business expense, especially if it is for large loans. Partners can also deduct the amount a property depreciates per year. Any expenses that a partner puts out for the continuing existence of a business can also be written off. Any other claims for deductions are allowed as long as there is valid justification. Corporation A corporation is a form of business organization that is chartered by the state and given many legal rights as separate from its legal owners. It is considered a juridical person as far as the law is concerned, therefore giving its owners limited liability.

The corporation also acts as a shield so that the owners' properties will not be affected in cases of losses and bad credits. Corporations may be stocked or non-stocked. The process of making a corporation is called incorporation. This process allows the corporation unique tax benefits and disadvantages that make it different from a sole proprietorship and partnership. Forming and registering a corporation requires a minimum of 5 incorporators, each of whom must be actual persons that must hold at least a single share in the company.

Majority of the incorporators must be Filipino residents, which is at least 60 percent. The first step to making a corporation is to verify the availability of the company name with the Securities and Exchange Commission. The process takes one day to complete and will involve paying forty pesos to have the name reserved for the month. The next step is to secure a bank

deposit slip for the paid-in capital. When done, the individual must prepare and register the incorporation papers, by submitting the verification and articles of incorporation papers and other documents to he SEC. The fourth step is to obtain a Community Tax Certificate or CTC which will cause a minimum of five hundred pesos. After that, the next step is to obtain a barangay clearance certificate which will cost up to a thousand pesos. The next step is to obrain a Mayor’s permit which will cost depending on the capital. Then, the next requirement is to register for taxes at the BIR. They will provide the company’s Tax Identification Number (TIN), and authority to print receipt/invoices and other documents.

After that, buy some accounting books that fit the BIR requirements, have the receipts and books stamped and register the employees. Along with starting a corporation, there are different kinds of taxes that the company will need to comply with. Corporation that are resident of the Philippines are taxed based on worldwide income. Corporations that only have their branches in the Philippines are taxed based only on the income they gain from the Philippines. They are taxed with Capital Gains Tax, Witholding Tax, Corporate Income Tax and Value Added Taxes. The corporations can pay their taxes in four quarterly instalments.

The Corporate Income Tax is 30% on worldwide income for domestic corporations and the same percentage is taxed on Foreign corporations for their local income. Capital Gains Taxes are usually taxed as income. The sales of shares not listed on the stock exchange are taxed as capital gains: 5% withholding tax on the first Php 100, 000. 00 and 10% on all that is above it. The sale of shares listed and traded on the stock exchange is taxed at 0.

5% of 1 % of the gross selling price. Real Estate Sales are taxed at 6% based on the gross selling price or the fair market value, whichever of them is higher.

Withholding tax is the money the corporation sends to the BIR as partial payment for its liabilities that year. Dividends distributed to non resident entities are subject to a 15% withholding tax as long as the country where the foreign corporation resides allows for a tax credit of 15%. Otherwise all dividends are subject to a 30% tax. Interest and Royalties are taxed at 30% for non residents. However, royalties paid to a Filipino corporation are taxed at 20%. Tax profits remitted to its main office are taxed at 15%. For Value Added Taxes, all its goods are subject to a VAT tax of 12%.

This payment can be paid for by increasing the prices of its goods. Because of this practice, it is ultimately the consumer that pays for this tax for the company. There are numerous items and amounts which the law allows to become corporate tax deductions. As of June 2008, the option to claim Optional Standard Deductions is available for corporations. Just like in sole proprietorship, it is 40% of the gross income. The corporation is still required to submit its financial statements and liabilities when it files its income tax return.

The corporation can still opt for the default Itemized deductions which contain Business expenses in general, interest payments, losses, bad debts, depreciation, depletion and charitable contributions are some of them. Because there is no limit in the itemized deductions allowed, it allows the corporate owners to fully take advantage of their juridical identity. They can

rent pent houses, put a table and consider them offices and it would be fully tax deductible. They can put their kids on the payroll with the company and it would be tax deductible.

They can even buy gym equipment because it is tax deductible. As long as the incorporators can justify its expenses, it can take advantage of this and reduce their gross income. Less gross income also means less taxable income. While the nature of tax exemptions may seem disadvantageous to the society, its purpose is to allow corporation must make up for its massive tax deductions by giving back to the community. The corporations themselves provide big help to the economy by giving boosts to the Gross Domestic Product or providing the country with more job opportunities.