Chapter 3
Forms of Construction Organizations

3.1 Introduction

As a prospective business Owner, one of his first decisions would be choosing a business structure that will suit his needs. Knowledge of the construction business organizations operating within the construction industry is therefore essential for an Owner and Engineer. The main basic forms of construction organizations are as follows:

(a) The sole proprietorship
(b) The partnership
(c) The corporation
(d) The joint venture

3.2 The Sole Proprietorship

A sole proprietorship is the most common form of construction organization. It is the simplest and least expansive method for establishing a construction business as it is owned and operated by just one person. This form necessitates very few legal requirements to set the business which include that the name of company must be registered with the registrar of the business as well as appropriate tax authorities to get a license to work as a contractor.

In Canada, a business name registration refers to a registration under the "Business Names Act." It expires after 5 years and must be renewed. Ontario, Canada, assigns a business identification number (BIN) when a business name is registered in Ontario. It should not be confused with the Federal Business Number (BN) assigned by the Canada Revenue Agency (CRA) for federal programs, including goods and services tax/harmonized sales tax (GST/HST), import/export accounts, payroll deductions, and corporate income tax.

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The sole proprietor operates as his own boss and has complete control over his business. He has the freedom to make any and all decisions unilaterally. He keeps all of the profit alone and does not have to share with others. The sole proprietor has low set-up costs relative to those of a corporation. All business transactions and contracts are made in the name of his firm providing him the freedom of action. Benefits include that any business losses may be applied against other incomes of the proprietor.

Conversely, as being an individual proprietor, losses are born entirely by the one person. The Owner remains liable for all debts, obligations, and responsibilities of the business. The Owner is also at risk for personal liability incurred through acts of the Owner's agents or employees. The other disadvantage is that at certain income levels, a sole proprietor is taxed at higher rates than corporations. In the event of the death of the Owner, the business cannot be continued, unless he will nominate someone to continue the business.

3.3 The Partnership (General)

A partnership is a group or association of two or more persons, who agree to own and run a business together. All partners contribute to the capital of the business and shares in the management of the business. Profits or losses are usually shared in the same proportion as the distribution of ownership.

In a business partnership, an individual partner cannot sell or mortgage partnership assets. The partnership company, like individual proprietorship, will also be registered with designated public authority as well as income tax authority. Usually the tax is charged to individual partners separately based on the overall income. In Canada, partnerships are governed by the "Partnership Act" in each province.

Primarily partnerships are setup by written agreement called "partnership agreement" or "deed of partnership." The agreement must state clearly the rights, responsibilities, and obligations of each partner. All partners can mention into a deed any points which are mutually accepted to each other and which will safeguard against any misunderstanding arising at a later stage.

The advantages of partnership are that, more capital can be invested into the construction business, the responsibilities and losses will be shared. The disadvantages could be that the company does not have a separate legal identity. If one of the partners dies or becomes bankrupt or withdraws, the partnership will be dissolved, unless a provision in the agreement is made that the business will continue and that the remaining partners will purchase the shares of the departed partner.

Moreover, in the event of disagreement, consulting all partners for decision will delay the construction and related issues. If one partner is inefficient or dishonest, the other partners will suffer due to his wrong actions. Each partner is jointly and severally liable for company debts. For example, if the partnership assets are insufficient to satisfy a creditor's claim, the partners' personal assets are subject to attachment and liquidation to pay the business debts.

Each general partner is deemed the agent of the partnership. Therefore, if any partner is carrying on partnership business, all general partners will be held liable for that partner's dealings with third persons.

3.3.1 Limited Partnership

In an ordinary or general partnership discussed above, each partner has unlimited liability to creditors. However, some partners may be willing to invest money in the firm but do not wish to participate in its management and have no voice or vote in the matters of management. Such a partner is called a limited partner, and the agreement is termed as a "limited partnership" also called sleeping partners.

Unlike the general partner, the limited partner is liable for partnership debts only to the amount of his investment in the partnership. The number of such partners could be one or more in the company; however, at least one of the partners must be a general partner, who could run the business. The limited partnership is usually used as a means of raising capital for the company. In case of death, disability, or withdrawal of a general partner, the partnership will be dissolved, unless the partnership agreement provides or all partners agree, in writing, to substitute a general partner. However, death or incompetence of a limited partner has no effect on the partnership.

3.4 Corporations

A major difference between a corporation and partnership is that a corporation is a legal entity that is separate from its shareholders/owners. Shareholders may receive dividends from the corporation and are entitled to receive the assets of the corporation upon liquidation once the corporation's debts and other obligations have been discharged. A shareholder of a corporation is not personally liable for the debts, obligations, or acts of the corporation. Whereas, a partnership is a business entity with individuals who share the risk and benefits of business. A corporation is a separate legal unit from its owners which means a partnership exists separately from the Owners/shareholders and will continue to exist if one of the owners should die or leave the business or if the ownership of the business changes. A corporation can make contracts or legal agreements, and its accounts are kept separate from the accounts of the owners. Like sole proprietorship and partnership, corporations also need to be registered in every province of Canada in which it does business as well as federally with Canada Revenue Agency.

Corporations are jointly owned by the people who have invested in the business. These people buy shares in the corporation, and they are therefore called shareholders. These shareholders appoint Directors to run the business. In a private limited

(Pvt. Ltd) company, the Directors are usually the most important or majority shareholders.

The advantages of private limited corporations are that the shares can be sold to a large number of people, usually relatives and friends, as they cannot advertise to sale the shares to the general public. The sale of shares leads to much larger sums of capital to invest in the business.

All shareholders have limited liability. It means that if the corporation fails with debts owing to creditors, the shareholders could not be forced to sell their possessions to settle the debts. The shareholders will only lose their original investment in the shares. Their liability is limited to that original investment. This is a major benefit compared to the position sole traders, and partners can find themselves in, if their business fails.

Since a corporation is treated as a separate legal unit under the law, it has the same rights as an individual, in that it can own property, investments, carry on business, borrow money, incur liabilities and debt, sue and be sued, etc. The corporation, being an independent unit, must have its own separate bank account, and the corporation's assets should not be mixed with the personal assets of its owners. The corporation must maintain its own set of financial/accounting books or records and must file corporate tax returns that are separate from the personal income tax returns of its owners.

The disadvantages are that incorporation is more complicated, expensive, and time-consuming to establish and maintain. Because corporations are regulated and monitored by the government, there is additional paperwork involved in their maintenance. In addition to extra bookkeeping, a minute book containing corporate bylaws, meeting minutes or resolutions, registers, and ledgers must be maintained.

Each individual in the corporation will be required to file two or three tax returns each year: one for their personal income and a separate one or two for their corporation's income. This will mean extra accounting fees and more time in bookkeeping. There is also possibility of higher taxation for incorporated businesses by double taxation. Corporate income is taxed at the corporate level when it is earned by the corporation, and it is taxed again at the personal level when it is removed from the corporation as a dividend. This effectively means that this income will be taxed twice. When losses arise in a corporation, they can only be offset against the earnings in that corporation; they cannot be transferred to the shareholders [1].

The other disadvantages are that a private limited corporation cannot be sold or transferred to anyone else without the agreement of the other shareholders. The account of a corporation does not remain as a secret; each year the latest accounts must be sent to the registrar of companies. The corporation cannot offer its shares to the general public so as to raise really large sums of capital to invest or expand the business.

Most of the engineering corporations start business as private companies. However, some corporations then may decide to convert to public corporations. In that case, the shares can be sold to the general public. Corporations that are controlled by the same person or group of persons are called "associated corporations."

3.5 The Joint Venture (JV)

For large scale projects, it has become popular for two or more contracting firms to unite forces through the setup of a joint venture. The members of a joint venture may be sole proprietorships, partnerships, or corporations, but the joint venture itself is a separate business entity and essentially a partnership limited to one particular project.

A joint venture allows the partners to combine resources, assets, and skills. This results in the advantage of pooling construction tools and plants, office facilities, personnel, and financial means. Each joint venture is responsible for the conduct of the work and shares in any profits or losses.

Joint ventures are frequently between local and foreign companies. Each foreign market offers unique opportunities and risks, and many firms naturally look to JVs with one or more partners for assistance in entering new markets. JVs have become a major feature of the international business landscape due to increased global competitiveness and technological innovation.

In Canada, there are no federal or provincial requirements that a foreign Designer or Contractor enter into a joint venture with a local contractor in order to design, build and be paid for their work. However, a foreign Contractor may be required by provincial law to register or be licensed as an "extra-provincial" corporation and may also require provincial or municipal registrations or licenses, or both, to engage in certain regulated activities. Foreign designers must be licensed by the Canadian province or territory in which they intend to work [2].

The formation of a JV can be a complex process. After a compatible joint venture partnership (JVP) is selected, the specific goals of the enterprise must be defined. The JV agreement should define clearly the scope of venture, obligation of the parties, working capital, percentage interest of each partner, division of profits and losses, etc.

3.5.1 Basic Elements of a Joint Venture

Basic elements constituting a joint venture are:

1. The parties should enter into a contract or an agreement that specify their mutual responsibilities and goals.
2. The parties should have joint control and management over the venture.
3. The parties should have a share in both loss and profit.
4. The parties should contribute property, cash and organizational capital, skills, knowledge, or efforts to achieve common goals.
5. The parties should work in a good faith in matters that concern the common interest of the venture.

It is not necessary that all items described above must be presented in establishing a joint venture. Simply a joint venture depends upon three elements: joint ownership, joint operation, and an express or implied agreement [3].

Moreover, the elements are required to establish JV matches with those of partnership but are not the same. A JV is more limited in scope and duration. Additionally, a JV is related to a single transaction, means for a particular purpose or project, while a partnership is typically related to a general and continuing business. Additionally, in a joint venture, each participant retains separate ownership of their property and shares only the expenses and revenue of the particular project or venture.

Another important difference between, a joint venture, partnerships and corporations is the manner in which courts assign liability when problems arise on a project. For partnerships, the law is quite clear; each partner is generally responsible for the entirety of all debts and liabilities of the partnership. There are exceptions to this general rule as some partnerships are designed specifically to limit the liability of individual partners. Nonetheless, full liability for each partner is the default rule. In joint ventures, by contrast, the liability of individual members is less certain. There is no simple default rule for liability. A clearly worded joint venture agreement can, however, help to determine how a court will apportion any liability between the members of the joint venture.

For corporations, the law is also quite clear; the corporation has a distinct legal personality, and it alone is liable for its debts, rather than its shareholders and officers [4].

3.5.2 Termination of Joint Ventures

A JV may be terminated due to a breach of the joint venture agreement. A JV may terminate upon achieving its objectives at a time specified in the contract as well as upon failing to meet its objectives. In addition, a change in the JV's objectives or those of a shareholder may also lead to the early termination of the JV. Disagreement by JV partners on fundamental management issues may also lead to termination. A JV may also be terminated due to sudden death of an active member or if a court decides termination is warranted given serious disagreements between the members making its continuation impractical.

References and Further Reading

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