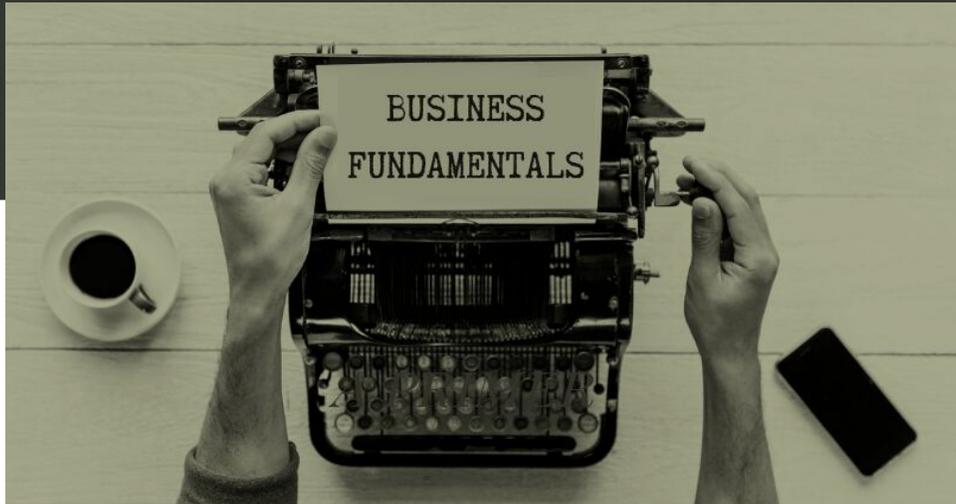


Business Fundamentals: What is a "Sole Proprietorship"?

01.09.19 | Linda J. Rosenthal, JD



We get this question all the time.

Derived from the word "proprietor" – and first used in 1537 – a sole proprietorship offers the most flexibility and greatest freedom of all the business forms. However, it is not a separate entity and has no separate existence from that of its owner. Often times, businesses begin as sole proprietorships and graduate to more complex business forms as the business develops.

A sole proprietorship can operate under the name of its owner or it can register and do business under a fictitious business name, or "DBA." The fictitious name is simply a trade name—it does not create a legal entity separate from the sole proprietor owner.

The sole proprietorship is popular among new business owners, as it's easy to set up very inexpensively. A sole proprietor only needs to register his or her trade name and secure local licenses to be ready to transact business (something we can help you with).

Perhaps the primary disadvantage of this business form is that the owner of a sole proprietorship will remain personally liable for all the business's debts and liabilities. So, if the business runs into financial trouble, creditors can (and will) bring lawsuits against the business owner in his or her individual capacity. If such suits are successful, the owner will be obligated to pay the business debts with personal assets.

A sole proprietor owner can, and often does, commingle personal and business property and funds, something that partnerships, Limited Liability Companies and corporations cannot do – and they often establish bank accounts in the name of the owner. Sole proprietors need not observe the requisite business formalities such as voting and annual meetings associated with corporations, social enterprises and LLCs.

Because a sole proprietorship is *indistinguishable* from its owner from the IRS's perspective, sole proprietorship taxation is quite simple. The income earned by a sole proprietorship is income earned by its owner. A sole proprietor reports the sole proprietorship income and/or losses and expenses

by filling out and filing the Schedule C, along with their normal Form 1040.

Further, as a sole proprietor you must also file a Schedule SE with your Form 1040. This form is used to calculate how much self-employment tax you owe. You must pay unemployment tax on any employees of the business, other than yourself – if the business fails, you aren't eligible to receive unemployment compensation.

Selection of this business form should be carefully considered, as ***the owner is personally liable for all potential liability of the business***, including any accidents that may happen, and any debts the business incurs. Accidents do happen, and businesses go out of business every day.

The advantages of a sole proprietorship:

- • Commingling of assets, both business and personal;
- • Set-up is quick, easily and inexpensive;
- No need to follow “corporate” formalities.

The disadvantages of a sole proprietorship:

- • Sole proprietors are open to unlimited personal liability for the debts, losses and liabilities of the business;
- • Sole proprietorships are linked to their owners, and can be wiped out by the death or disability of the owner, and thus do not retain their value;
- No access to capital investment.