SOLE PROPRIETORSHIPS

DEFINITION

A sole proprietorship is a form of business which is unincorporated and owned by one individual. It is considered to be the simplest form of business to set up, since it is not a separate legal entity, unlike a corporation or a partnership. The profits and losses of a sole proprietorship are passed through to the owner who also assumes all debts and liabilities.

HOW THEY WORK

SETUP

A sole proprietorship is the simplest of all business structures to set up. A business owner generally does not have to file any special forms or pay upfront fees to be a sole proprietor. However, most cities and counties require businesses to register with them and obtain a business license. They may also have to request for additional items, such as an employer identification number from the IRS (if they have employees), a seller's license from the state, and/or a zoning permit from the local planning board.

TAXATION

A sole proprietorship is not legally separate from the person who owns it. Since a sole proprietorship and its owner are essentially the same, they report all business income or losses on his or her individual income tax return. Sole proprietors are responsible for paying all federal and state income taxes (through withholdings or estimated tax payments). They also are subject to “self-employment taxes” which consists of contributions to Social Security and Medicare programs.

DEBTS AND LIABILITIES

Since there is no legal distinction between the owner and the business, a sole proprietor is liable for the debts and liabilities incurred by the entity. The owner can lose their personal assets due to losses incurred by the business and any liabilities resulting from the acts committed by the company’s employees. This is a distinct disadvantage from a corporation or partnership where owners’ liability is limited to his or her participation in the business.

CONTINUITY

Unfortunately, due to the fact that the sole proprietor essentially is the business, the company may be adversely affected or terminated if the owner becomes ill, disabled, or passes away. A sole proprietorship terminates by law upon the death of the sole proprietor. In addition, the ability to sell a sole proprietorship may be limited, as the value of the company is often dependent on the sole proprietor’s involvement in the company.