Sole Proprietorship – Is The Risk Worth It?

Article Highlights:

- Reporting Sole Proprietorships On Your 1040
- Business Checking Account
- Local Business Licenses
- Resale Permits & Payroll Reporting
- Personal Liability

If you are considering starting a business, the simplest and least expensive form of business is a sole proprietorship. A sole proprietorship is a one-person business that reports its income directly on the individual's personal tax return (Form 1040) using a Schedule C. There is no need to file a separate tax return as is required by a partnership or corporation (if the business is set up as an LLC with just one member, filing is still done on Schedule C, although an LLC return may also be required by the state). Generally, there are very few bureaucratic hoops to jump through to get started.

However, we strongly recommend that you open a checking account that is used solely for depositing business income and paying business expenses. You will also need to check and see if there is a need to register for a local government business license and permit (if required for your business).

If you are conducting a retail business, you will need to obtain a resale permit and collect and remit local and state sales taxes.

If you hire employees, you will need to set up payroll withholding and remit payroll taxes to the government. Before you can do that, however, you'll need to apply to the IRS for an employer identification number (EIN) because you can't just use your Social Security number for payroll tax purposes. An EIN can be obtained online at the IRS web site or by completing a paper Form SS-4 and submitting it to the IRS.

As a sole proprietor, you can also very simply set aside tax-deductible contributions for your retirement.

Example: *Paul has been working for a computer firm as an installation specialist but has decided to go out on his own. Unless he sets up a partnership, LLC or corporation, Paul is automatically classified as a sole proprietor. He does not need to file any legal paperwork. His business is automatically classified and treated as a sole proprietorship in the eyes of the IRS and his state government.*

However, there is a big downside to conducting business as a sole proprietor, and that drawback is liability. Sole proprietors are 100% personally liable for all business debts and legal claims. As an example, in the case that a customer or vendor has an accident and is injured on your business property and then sues, you the owner are responsible for paying any resulting court award. Thus, all your assets, both business and personal, can be taken by a court order and sold to repay business debts and judgments. That would include your car, home, bank accounts and other personal assets.

Other forms of business, such as LLCs and corporations, can protect your personal assets from business liabilities. If you feel that your business is susceptible to lawsuits and would like to explore alternative forms of business, please give this office a call so we can discuss the tax ramifications of the various business entities with you. If you decide on something other than a sole proprietorship, you'll need legal assistance to formally set up your new business.