Start a Small Business in 2021 with What you have.

Looking to start your own business? A sole proprietorship may be the perfect fit.

Sole proprietorships do not offer legal protection over your personal assets if you face a lawsuit or financial trouble.

- When registering your sole proprietorship within your state, you may have to file a doing-business-as application and register for an employer identification number.
- Sole proprietorships require the least amount of administrative work of any incorporated entity.
- **This article is for business owners who want to know how to start a sole proprietorship and learn about its benefits.**

A sole proprietorship is a common business type that many business owners use when starting a company. Starting a sole proprietorship is a very simple process and should take only a few short steps to get off the ground.

What is a sole proprietorship?

A sole proprietorship is a type of business structure that is the Internal Revenue Service's automatic classification for any business started by an individual. Having a sole proprietorship means you and your business have a shared identity, so the business isn't a separate legal entity. As the owner, you take on all of the legal responsibility if your business is sued or faces financial troubles. This is the biggest risk of a sole proprietorship.

Examples of sole proprietorships

Here are some examples of professionals that may form sole proprietorships to offer their services to clients and customers:

- Chefs
- Accountants
- Writers
- Personal trainers
- Landscapers
- Editors

Key takeaway: **Sole proprietorships are business entities that share full legal responsibility with one business owner. This means that if the company is sued, the business owner's personal assets are at stake.**

Steps to starting a sole proprietorship

A sole proprietorship is very simple to get up and running. Because you don't have to register your business with the state, there aren't many formal steps. However, there are certain things you may want to apply for, depending on certain changes you might like to make to your business. Here are some steps you may want to take:

Step 1: Change your business name.

If you want your business to legally be called a name other than your own, you will have to establish what is known as a DBA. In a sole proprietorship, the sole owner is legally required to use their personal name as their domain name unless they follow the process to change the name.

To change the name of the sole proprietorship to a brand name, you must file a doing-business-as application, which gives you the option of using a different name. You must file the doing-business-as (DBA) application with the state, often through the secretary of state's office, though the specific agency can vary from state to state. A DBA application can cost between $5 and $100 depending on the state.

When choosing a name, you must make sure it doesn't already belong to someone else. You also don't want to pick a name that is too similar to someone else's. To check whether the name you want is available, visit the U.S. Patent and Trademark Office site or search your state's DBA registry.

Step 2: Get an employer identification number.

As a sole proprietor, you will also need a federal employer identification number (EIN), which the IRS uses to identify your company when you pay taxes. Some banks even require an EIN to open a business bank account.

Step 3: Open a business bank account.

Having a bank account that is separate from your personal one helps to keep your finances organized and less entwined with your private funds.

"This is a requirement to separate business money from your personal money," said Julia Brookes, a Now Loans finance consultant. "This will also give you a clearer view of your profit and increases your credibility in the bank in case you needed to apply for a loan."

However, as a sole proprietor, your business's assets are not legally considered separate from your personal assets, as would be the case for an LLC, for example; there is no limited liability associated with a sole proprietorship.

Step 4: Secure the proper paperwork needed in your state.

Depending on your industry, you may need certain business licenses, permits or zoning clearance to operate legally. Check your state's requirements for building permits or regulations for your type of business so that you remain compliant with all applicable laws and regulations.

***Key takeaway:* There aren't mandatory steps you need to take to file as a sole proprietorship, but you may want to file a doing-business-as application and get an employer identification number to register as an official business.**

Types of business entities to consider

Apart from a sole proprietorship, there are several other business entities that could be a better fit for your company. These entities offer limited liability, meaning your business's assets are considered separate from your personal assets, thereby protecting your personal assets in the event of fines or lawsuits.

Limited liability company (LLC)

Unlike a sole proprietorship, this business structure protects your personal assets from any legal trouble your LLC may face, meaning you aren't held personally responsible if your business is sued. An LLC is also known as a "pass-through entity" because business income isn't subject to a corporate income tax. Instead, profits are taxed as personal income only when paid out to the owner or owners. In other words, company income "passes through" to owners and is then subject to personal income tax rates.

Partnership

A partnership is when two or more people share ownership of a business.

"If you have friends that want to pool in their money, you can opt to form a partnership," said Jeremy Harrison, founder of Hustle Life. "It gets a little bit complicated because you need to agree with all the partners to come up with the stipulations and agreement."

Corporations

Corporations are considered separate entities from their owners. There are five kinds of corporations: C corporations, S corporations, B corporations, close corporations and nonprofit corporations. Each of these corporation types has different requirements regarding governance structure and taxation.

***Key takeaway:* In addition to sole proprietorships, other types of business entities include limited liability companies, partnerships and corporations.**

What are the benefits of a sole proprietorship?

Many businesses start out as sole proprietorships, and there's a good reason to do so: A sole proprietorship is very simple and inexpensive to process.

"There is no cost to organize, and you don't have to renew your business entity yearly with the state," said Matt Jensen, a certified public accountant at Cook Martin Poulson. There are no requirements for annual owner meetings or filings with states, and in general, there is less administrative work, he said.

Key takeaway: **Sole proprietorships do not need to be renewed annually, they require less paperwork and they don't cost much to process.**

What are the disadvantages of a sole proprietorship?

Although a sole proprietorship is one of the simpler business entities, it puts a lot of responsibility on business owners. It offers zero legal protection of your personal assets, and there can be only one owner.

"If a business owner was sued, the owners could literally lose their personal car and personal home because of a business liability," Jensen told Business News Daily.

Sole proprietorship also poses some security risks. "Another con is that when a business identification number is needed, the owner has to give out their Social Security number, greatly increasing the chance of identity fraud," Jensen said.

Another drawback is that sole proprietors are not eligible for certain business tax breaks and small business loans. They could, however, be eligible for certain tax deductions intended for self-employed individuals.

Key takeaway: **Sole proprietorships provide no legal protection for business owners' personal assets and aren't eligible for certain business tax breaks or small business loans.**

What are the tax implications of a sole proprietorship?

When filing your taxes as a sole proprietorship, you report your business's income and losses on your personal tax returns. You're also required to submit a Schedule C, "Profit or Loss from the Business," as part of your IRS 1040 filing. This form is used to document the income and expenses for your business.

"A sole proprietorship doesn't have to file a separate [business] tax return," Jensen said. "A business schedule is attached to the owner's personal tax return."

Income earned by sole proprietorships is treated like personal income, which is why it's reported on your personal tax return.

You may instead be able to submit Schedule C-EZ, which documents your net profit from the business. Because the sole proprietor is considered both the employer and the employee, he or she is responsible for paying both the employer and employee portions of Social Security and Medicare taxes through Form SE, "Self-Employment Tax." The employer portion of the tax can be claimed as a tax deduction when filing your tax return, however.