

Sole proprietorship as a business structure - Advantages & disadvantages

Do you know what sole proprietorship is? A sole proprietorship is a business which has only one owner. It is a "sole" proprietor in the sense that the owner has no partners. A sole proprietorship essentially means a person does business in his own name and there is only one owner. A sole proprietorship is not a corporation, it does not pay corporate taxes, but rather the person who organized the business pays personal income taxes on the profits, making accounting much simpler.

Most sole proprietors will register a trade name "Doing Business As". This allows the proprietor to do business with a name other than their legal name and also allows them to open a business account with banking institutions.

A sole proprietorship has an authority to hire any number of employees because the law makes no distinction between you, the sole proprietor, and the business. Sole proprietorship has also an authority to hire independent contractors of their own choice.

Whether the proprietor has zero or 100 employees or independent contractors, it doesn't make any difference. If you are the sole owner, your business will still be a sole proprietorship.

There are several advantages associated with operating as a sole proprietor. Starting a business as a sole proprietor brings two tax advantages. The first advantage is avoidance of double tax.

Double tax can occur if you carry out your business through a corporation. Corporations are considered as separate entities consisting of many partners or owners. As a result the corporation owners will pay tax on their individual income and the corporation will pay tax on any profits made by the company. As a sole proprietor, you will not pay double tax on your business income because the law makes no difference between you, the sole proprietor, and your sole proprietorship and the business income is treated as your personal income.

The second tax advantage of sole proprietorships is that you can deduct your business losses to the extent of your total income that you may have from all sources, including interest, dividends, and profits.

Operating as a sole proprietor also has some drawbacks. A business organized as a sole proprietorship faces difficulty in raising own capital since shares of the business cannot be sold. Hiring employees may also be difficult. This form of business will have unlimited liability, therefore, if the business is sued, it is the proprietor's who will be responsible.

The second disadvantage is that as a business grows, the risks accompanying the business also tends to grow. To minimize those risks, a sole proprietor has the option of forming a limited liability company.

The principle disadvantage of sole proprietorships is that you are personally responsible for all the debts and the reason for this is that the law makes no distinction between you, the sole proprietor, and your sole proprietorship authorities.

Another disadvantage of sole proprietorship is that you may have to pay high income taxes. You cannot take any tax deduction for your health or life insurance whilst operating as a sole proprietor. A full deduction for your health insurance and a deduction of life insurance policy are offered to corporations, so long as all employees of the corporation are offered the insurance.

In this competition of different businesses, every business is different from each other i.e one thing giving advantage to you may be a disadvantageous thing for the other business. Selecting the best business structure will depend on the factors including your type of business, tax situation, and industry liability among others. Your selection of business structure will have legal and personal applications and therefore it is always advisable to seek professional help in such matters. Getting on the track from day one will take you further and ease your problems in the long run.

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About the Author

William King is the director of [UK Wholesale Suppliers](#), [Wholesale Suppliers](#), [Dropshipping Directory](#) and [Pakistan Property Portal](#). He has 18 years of experience in the marketing and trading industries and has been helping retailers and startups with their product sourcing, promotion, marketing and supply chain requirements.

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