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SOLE PROPRIETORSHIPS

(Choosing the Proper Entity for Your Business – Part 1)

By Victor Sy, CPA, MBA

You have decided to go into business for yourself. Should you operate as a sole proprietorship, partnership, corporation, LLC, or LLP? How do you select which entity is most beneficial for you? Choosing the wrong form could cause unnecessary taxes, increased liability, and unnecessary exposure to lawsuits. What you should *not* do is listen to your neighbor or friend because each one has a different set of circumstances calling for a different set of strategies, a different form of entity. What you should do is seek professional advice to help you understand the attributes of each form and evaluate a whole multitude of confusing tax, legal and personal issues. The objective here is to set *you* up with a form that is tailored to *your* particular needs, *your* particular industry, and *your* particular business. Read on and allow me to describe the nature, advantages and disadvantages of each form of entity.

SOLE PROPRIETORSHIP: This is the simplest form of doing business. The business is your own alter ego. It does not require any legal filing with the State of California. It does not file a separate return. You merely include form Schedule C with your individual income tax return. This is often referred as a DBA (Doing Business As) that is rather inaccurate because a partnership or corporation can also have a DBA. The need for a DBA occurs when you decide not to use your name and instead opt to use a fictitious name to hold your business out to the public. For example, John Smith decides to run his auto parts retail business as Acme Auto Parts. This name has to be registered in the county where the business is located. Caveat: The most common error of sole proprietors that I have encountered over 23 years of practice is the commingling of personal and business assets, income, and expenses. You need to open a business checking account to which all business revenues are deposited and from which all business expenses are paid. Take a periodic draw. Deposit a check from the business account to your personal account from which you pay mortgage, grocery and other personal expenses. Read on to review the pluses and minuses of being a sole proprietor.

A. Advantages:

1. It is simple. Administration and organizational needs are less complicated.
2. It is less expensive to organize because there are no legal papers except minimal DBA filing costs.
3. Federal and state taxes are usually lower (no double taxation for regular corporations).
4. You save on FICA (Social Security tax) on the wages of your children under 18 years old.
5. You save on FUTA (unemployment tax) on the wages of your children under 21 years old.

B. Disadvantages:

1. You are **exposed** to personal liabilities from business-related lawsuits. So is your business from personal-related lawsuits. A successful plaintiff against the business can come after your personal assets; so can a plaintiff against you go after your business assets.
2. You have a **high risk of being audited by the IRS**. Schedule Cs are a prime target for audits.
3. You have to pay self-employment tax (social security tax) of about 15%.
4. Your fringe benefits are limited (compared to other forms of entity).