What is a sole proprietorship?

A sole proprietorship is the business or an individual who has decided not to carry his business as a separate legal entity, such as a corporation, partnership or limited liability company. This kind of business is not a separate entity. Any time a person regularly provides services for a fee, sells things at a flea market or engage in any business activity whose primary purpose is to make a profit, that person is a sole proprietor. If they carry on business activity to make profit or income, the IRS requires that you file a separate Schedule C "Profit or Loss From a Business" with your annual individual income tax return. Schedule C summarizes your income and expenses from your sole proprietorship business.

As the sold proprietor of a business, you have unlimited liability, meaning that if your business can't pay all it liabilities, the creditors to whom your business owes money can come after your personal assets. Many part-time entrepreneurs may not know this, but it's an enormous financial risk. If they are sued or can't pay their bills, they are personally liable for the business's liabilities.

A sole proprietorship has no other owners to prepare financial statements for, but the proprietor should still prepare these statements to know how his business is doing. Banks usually require financial statements from sole proprietors who apply for loans. A partnership needs to maintain a separate capital or ownership account for each partners. The total profit of the firm is allocated into these capital accounts, as spelled out in the partnership agreement. Although sole proprietors don't have separate invested capital from retained earnings like corporations do, they still need to keep these two separate accounts for owners' equity - not only to track the business, but for the benefit of any future buyers of the business.