



Risk Concepts

Sole Proprietorship

Historically, farms and ranches were operated as sole proprietorships. The land, machinery, livestock, and other assets were owned and used by an individual or couple. Likewise, the individual (or husband and wife) farmer/rancher was personally responsible for all debts and financial obligations owed by the business. The farmer or rancher was the business, and the business was the farmer or rancher.

There are a number of organizational structures that may better meet the needs of today's farm/ranch business. A few of the more common business entities used by farmers and ranchers include sole proprietorship, general partnership, limited partnership, limited liability company (LLC), and corporation. Each U.S. state recognizes most legal entities, while the U.S. Internal Revenue Code recognizes all business forms except LLCs. Each organizational structure has its strengths and weaknesses. Before a decision is made as to the legal entity under which to operate, a person – or person and his or her family and other partners – need to determine the goals of and needs for the business and its assets.

The sole proprietorship is the simplest business form under which one can operate a business. The sole proprietorship is not a legal entity. It simply refers to a person who owns the business and is personally responsible for its debts. A sole proprietorship can operate under the name of its owner or it can do business under a fictitious name. The fictitious name is simply a trade name—it does not create a legal entity separate from the sole proprietor owner.

Formation

One of the great features of a sole proprietorship is the simplicity of formation. Little more than buying and selling goods or services is needed. In fact, no formal filing or event is required to form a sole proprietorship. A sole proprietorship, generally, has



no annual filing requirements with the Secretary of State in a particular state. In those cases where the owner has previously filed “doing business as” or “dba” papers, the status must be renewed annually.

Operational Attributes

The owner of a sole proprietorship typically signs contracts in his or her own name. The sole proprietor owner will typically have customers write checks in the owner’s name, even if the business uses a fictitious name. Sole proprietor owners can, and often do, commingle personal and business property and funds. Sole proprietorships often have their bank accounts in the name of the owner.

Sole proprietors need not observe formalities such as voting and meetings associated with the more complex business forms. Sole proprietorships can bring lawsuits (and can be sued) using the name of the sole proprietor owner. Many businesses begin as sole proprietorships and graduate to more complex business forms as the business develops.

The Social Security number of the owner of a sole proprietorship is used on many income tax and other business forms. However, a federal employer tax identification number (FEIN or EIN) will need to be obtained for filing employer-employee forms (e.g. W-2).

Liability

A sole proprietor is personally liable for all debts of a sole proprietorship business. Further, a sole proprietor is personally liable for any legal issues and lawsuits brought against the business. Consequently, all business-related liabilities will have to be paid with all assets owned by the sole proprietor.

Tax Attributes

A sole proprietorship has no separate tax status. It is recognized by the Internal Revenue Service as an extension of the owner.

Because a sole proprietorship is indistinguishable from its owner, sole proprietorship taxation does not have some of the complexities common to other legal entities. The income earned by a sole proprietorship is income earned by its owner.

A sole proprietor reports the sole proprietorship income and/or losses and expenses by filling out and filing a business reporting form, such as Schedule C or Schedule F. Then the “bottom-line amount” from Schedule C or Schedule F is transferred to the owner’s personal tax return. This aspect is attractive because business losses may offset income earned from other sources.

A sole proprietor must compute and file self-employment taxes for himself or herself. A sole proprietor need not pay unemployment tax on himself or herself, although unemployment taxes must be paid on any employees of the business. Of course, a sole proprietor won’t enjoy unemployment benefits should the business suffer.

Succession and Estate Planning

There are no specific rules nor strategies for transferring ownership of assets and the business under a sole proprietorship. The farm or ranch owner includes all property in his/her individual estate plan.



Dissolution

A sole proprietorship is terminated (1) when the owner sells the business-related assets, (2) when the owner gifts the business related assets to another person, or (3) upon the individual's death.

Summary

The sole proprietorship is the simplest business form under which one can operate a business. The sole proprietorship is not a legal entity. It simply refers to a person who owns the business and is personally responsible for its debts. A sole proprietorship can operate under the name of its owner or it can do business under a fictitious name. The fictitious name is simply a trade name—it does not create a legal entity separate from the sole proprietor owner.

A person wanting to start a business should first determine his or her risk preferences and both short and long term goals; second, seek appropriate professional counsel from an attorney, accountant, and others; and finally, establish the business.

Resources

Part I: An Overview of Organizational and Ownership Options Available to Agricultural Enterprises. Goforth, Carol R. An Agricultural Law Research Article. National Agricultural Law Center. July 2002.

Part II: An Overview of Organizational and Ownership Options Available to Agricultural Enterprises. Goforth, Carol R. An Agricultural Law Research Article. National Agricultural Law Center. July 2002.

Fact Sheets from the Internal Revenue Service and Secretary of State office in various states.

The information presented in this document is intended for educational purposes only. It should not be construed as providing legal, accounting, or other professional advice. People considering the establishment of a business enterprise should seek appropriate professional assistance.



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