

Sole Proprietor vs. LLC

Your guide to the pro's and con's of both business forms

by Jackie from Jade and Oak

What is a sole proprietorship?

A sole proprietorship is the easiest business form. It's where you are running an unincorporated business by yourself and there is no legal distinction between the **you** and **your business**. You get all of the profits, but you are also responsible for all of the business's losses, debts and liabilities.

How do you create a sole proprietorship?

You don't need to affirmatively do anything in order to form a sole proprietorship. So if you are making money right now with your business and you haven't filed anything, then congrats - you're already a sole proprietor! However, you may need to obtain certain licenses or permits, depending on the work that you're doing, the industry you're in and where you are located. Check with your state.

You can operate your business under your own name, but you can also file a fictitious name (an assumed name, trade name or DBA name). You must choose an original name that isn't already being used by another business.

When you're a sole proprietor, you and your business aren't separate legal entities. The business isn't taxed separately, meaning that any income you earn in your business is personal income. You file your business's taxes along with your personal taxes. When you file your personal taxes, you will also file your income, losses and/or expenses with a Schedule C along with your usual Form 1040. It is your own responsibility to withhold and pay all income taxes, including self-employment tax and estimated tax.

Benefits

- ◆ A sole proprietorship is easy and cheap to form.
- ◆ You have total control over any business decisions since you're working alone.
- ◆ Taxes are easy and you file the businesses taxes right along with your personal taxes. The tax rates are also low.

Drawbacks

- ◆ There is no legal distinction between you and your business, so you have unlimited personal liability.

- ◆ As a sole proprietor, it's totally up to you to raise money for your business.
- ◆ You have total total, but also all responsibilities.

What is an LLC?

LLC is short for "limited liability company" and the main benefit is that you have limited liability because the business is separate from you as an individual. Therefore, except for in some limited circumstances, your personal assets are protected against losses, debts or liabilities. This can be a great advantage if you are worried about whether you might open yourself up to liability in your business.

You can own an LLC by yourself or with other individuals. The profits and losses of the LLC "pass through" the business entity and the individual owner (or owners) is then taxed on her personal tax filing. An LLC is not seen as a separate tax entity, so the business itself isn't taxed. The federal government doesn't tax income on an LLC, but some states do so be sure to check with your state's income tax agency.

Because an LLC isn't recognized by the federal government as a separate taxable entity, LLCs must actually file as a corporation, partnership or sole proprietorship tax return. Some LLCs are automatically classified and taxed as a corporation by federal tax law, but those that aren't can choose their business entity classification (by filing Form 8832).

It is possible to request S-Corp status for your LLC, which requires a special election with the IRS to be taxed different. You can contact a local attorney for help deciding if this is right for you. This can be benefit because the LLC still has limited liability, but for tax purposes it can be treated as an S-Corp. If you want to go this route, contact your state's income tax agency.

How do you set up your business as an LLC?

The procedures for forming an LLC vary slightly by state, but there are some general principles that apply. Research your state to see your state's specific requirements. You will file with your state's Secretary of State (or possible a different office in your state), fill out a form and pay a fee.

Benefits

- ◆ The major advantage of the LLC is that you are protected from personal liability, so if the LLC gets sued or incurs debts, you personal assets are exempt (except in some limited situations).
- ◆ An LLC requires less record keeping and there are less start up costs as compared to a traditional corporation.
- ◆ Profit sharing within an LLC is much easier than within a corporation.

Drawbacks

- ◆ Setting up an LLC requires more time and effort than being a sole proprietor.
- ◆ Members of an LLC are considered self-employed and must pay their own self-employment and income taxes.
- ◆ If you have an LLC with other members, many states will dissolve the LLC if a member leaves.

How to decide for your business

Factors to consider for your business:

- ◆ Whether you're interested in limited liability for your business.
- ◆ If you feel that being an LLC will make your business look more "professional."

- ◆ Forming an LLC can cost more money as compared to a sole proprietorship, so do a cost/benefit for yourself.
- ◆ There are can be some tax benefits of forming an LLC - consult with a tax professional or attorney to get more info on your personal situation.
- ◆ Being a sole proprietor is a time saver since you don't need to file anything. Filing an LLC can be a little more time consuming, so decide if that's worth it to you.
- ◆ If you do nothing at all, you are already a sole proprietorship. But you can always change to an LLC at a later date. So really, it's all about figuring out if you want to go from a sole proprietor to an LLC and file the necessary paperwork.

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