

## Small Business Introduction

I'm writing this series of articles because I've talked to and prepared tax returns for several people who don't realize that the IRS considers them a business. Also, there are many people who intentionally create a business, but do not think about what type of business entity they are creating. I'm hoping to shed some light on the tax consequences as well as liability implications as they relate to the business entity.

### Sole Proprietorship

The first and probably the most common business entity is the Sole Proprietorship. This entity doesn't require any filing with the state and that's probably the reason why it's the most common. So, if you go into business on your own, like a plumber, electrician, website designer, etc. and don't register your business as some other entity with your state, then you're probably a Sole Proprietor. What many people don't know is that even contractors are self-employed business owners. For example, if your "employer" issues a 1099-MISC to you after the tax year, the IRS treats you as self-employed with respect to the income you received on the 1099-MISC. Usually Box 7 of the form will have the amount that you were paid for the tax year. If you also receive a W-2 from another employer, you are both an employee and self-employed. What does it mean to be a Sole Proprietorship?

### Liability

There is no separation between your business assets and your personal assets. If you get sued for something that you do in your business, all of your assets, business and personal, are at risk. The same is true if you get sued on your personal side, your business assets are at risk too. As you can see, this can be a very risky business entity.

### Income Tax Reporting

You would prepare IRS Form 1040, and report business income and expenses on Schedule C. If you actually work for someone and your wages are reported on Form W-2, and you also run a business and either get issued or do not get issued a 1099-MISC, you report all of your income on the same tax return. You do not create two tax returns, just one that contains both your W-2 wages and your business income.

### Additional Taxes

If you are an employee, Social Security taxes are withheld through the FICA system. Under this system, half of the Social Security taxes are paid by your employer, and the other half is paid by you. However, if you have income from self-employment, you are going to have to pay the entire Social Security tax on this income. This is in addition to income tax, and usually comes as a surprise to new self-employed individuals. Additionally, you may be required to make estimated tax payments throughout the year.

### Reporting Requirements

The filing requirements for W-2 income (employee wages) and self-employment income are different. For W-2 income, the threshold is the filing status standard deduction plus the personal exemption(s). For example, if your filing status is Single, the 2011 standard deduction is \$5800 and the personal exemption is \$3700. So if you make less than \$9500 (\$5800 + \$3700), then you do not have to file an income tax return. However, if you have self-employment income of \$400 or more, you must file.