

Chapter 02

Sole Proprietorship

❖ Merits of Sole Proprietorship

A sole proprietorship is a business that is directly owned by a single individual. It is not incorporated, so that the sole owner is entitled to the entire net worth of the business, and is personally liable for its debts. The individual and the business are considered to be the same entity for tax purposes

- Easy formation and closure
- Direct motivation
- Maintenance of business secrets
- Quick decision and prompt action
- Better control
- Flexibility in operation
- Least record keeping
- Close personal relation

A sole proprietorship is among the **oldest and simplest business forms** wherein, only one man heads the entire show. Some common examples of sole proprietorship business are **grocery shop, chemist shops, beauty parlours, fabrication units** and so on.

❖ Demerits of Sole Proprietorship

- Limited resources
- Limited managerial ability
- Lack of continuity
- Limited size
- Unlimited liability

In spite of various shortcomings, many businesspersons choose sole proprietorship business, especially startup founders, due to its inherent benefits. Such business is appropriate where the market for the product is limited or when the customers demand personalised services. It also suits to the businesses where manual skills are required or where the capital required to start the business is relatively small and does not involve a high degree of risk.

❖ The limitations of Sole Proprietorship

Forming a sole proprietorship does involve some risks, mainly to the owner of the business, as legally speaking they are not treated separately from the business. Some disadvantages of sole proprietorship are-

1. **Liability:** The business owner will be held directly responsible for any losses, debts, or violations coming from the business. For example if the business must pay any debts, these will be satisfied from the owner's own personal funds. The owner could be sued for any unlawful acts committed by the employees. This is drastically different from corporations, wherein the members enjoy limited liability (i.e., they cannot be held liable for losses or violations)
2. **Taxes:** While there are many tax benefits to sole proprietorships, a main drawback is that the owner must pay self-employment taxes. Also, some tax

benefits may not be deductible, such as health insurance premiums for employees.

3. **Lack of “continuity”:** The business does not continue if the owner becomes deceased or incapacitated, since they are treated as one and the same. Upon the owner’s death, the business is liquidated and becomes part of the owner’s personal estate, to be distributed to This can result in heavy tax consequences on beneficiaries due to inheritance taxes and estate taxes.
4. **Difficulty in raising capital:** Since the initial funds are usually provided by the owner, it can be difficult to generate capital. Sole proprietorships do not issue stocks or other money-generating investments like corporations do.

So, while sole proprietorship do not necessarily create more liabilities, they do expose the business owner to a risk of being sued. Lawsuits can be filed against the business owner for legal violations, as well as to collect any outstanding debts. State the limitations of sole proprietorship business.

❖ What are the reasons why sole proprietorship businesses are popular?

sole proprietorship is the most flexible type of business because:

1. The easiest form of business, as there are no complexities in handling or managing it
2. Sole Proprietorships do not require mandatory registrations, thus making them easier to start
3. Minimal investment required in the initial years
4. 100% of the profit goes the owner
5. Lesser legal compliances
6. Lesser income tax
7. Flexibility in operating the firm and decision making
8. No specific audit requirement