

# Business Organizations & Corporate Law: Chapter 3

## Introduction

Business Organizations & Corporate Law: Chapter 3

Applying Concepts

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Introduction

Chapter 3

### Sole Proprietorships

**Chapter Outline**

- I. Introduction
- II. Sole Proprietorship
  - A. Concerns and Issues for Sole Proprietorships
    - 1. Financing Problems
  - B. The Advantages of Sole Proprietorships
    - 1. Organization of the Business
    - 2. Complete Control
    - 3. Profits
    - 4. Tax Advantages
  - C. The Disadvantages of Sole Proprietorships
    - 1. Personal Commitment
    - 2. Financial Commitment

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Chapter 3

## Sole Proprietorships

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I. Introduction

II. Sole Proprietorship

A. Concerns and Issues for Sole Proprietorships

1. Financing Problems

B. The Advantages of Sole Proprietorships

1. Organization of the Business

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- 3. Profits
  - 4. Tax Advantages
  - C. The Disadvantages of Sole Proprietorships
    - 1. Personal Commitment
    - 2. Financial Commitment
      - a. Obtaining Credit
    - 3. Limited Existence
    - 4. Personal Liability
  - D. Dissolution of a Sole Proprietorship
- III. Regulatory Concerns for Sole Proprietorships
- A. Federal Tax Concerns for the Sole Proprietors
    - 1. Employees
      - a. Spouses as Employees
      - b. Employer Identification Number
  - B. State Requirements
  - C. Building Permits, Business Licenses, and Other Concerns
    - 1. Building Permits
    - 2. Business Licenses
    - 3. Miscellaneous Governmental Regulations
      - a. Zoning Regulations
      - b. Health Inspections
      - c. Safety Inspections
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# Applying Concepts



The screenshot shows a software interface with a sidebar on the left containing six buttons: 'Applying Concepts' (highlighted), 'Chapter Review', 'eLecture: Review Answers', 'Reflection', 'Reflection Responses', and 'Chapter Quiz'. The main content area is titled 'Applying Concepts' and contains the following text:

**Instructions:** Email your responses to your instructor, making clear that your answers are for the *Applying Concepts* segment of Chapter 3.

Contact your local government and gather information about the following issues:

- Where does a new business owner apply in order to obtain a business license?
- If the business is a retail establishment, what fees, inspections, or assessments are required before the business can be opened?
- If the business will be serving food to the public, what health inspections are required?
- If the client intends to change a retail store into a restaurant, is a building permit required? If so, where does the client go to obtain a building permit?

*The answers to all these questions will vary depending on your locale.*

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## Chapter Review

**Chapter Review**

1. Explain why a sole proprietorship is simple to create and maintain.
2. What tax advantages does a sole proprietorship offer?
3. What are some of the financial concerns facing sole proprietors?
4. What organizational steps must a sole proprietor go through in order to begin his or her new business?
5. Explain the cash flow arrangement in a sole proprietorship.
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6. The text mentions that sole proprietors have complete control over their businesses but also shows that there are some practical limitations. Discuss these limitations.
  7. Describe the tax advantages of sole proprietorships.
  8. Why are the time and personal commitments considered to be disadvantages in the sole proprietorship?
  9. Why is it difficult for new businesses to obtain financing and credit?
  10. One of the disadvantages of a sole proprietorship is the fact that it has limited existence. What does this phrase mean?
  11. Explain the personal liability that a sole proprietor has in his or her business.
  12. Is it possible to sue a sole proprietorship after the owner is dead? Explain.
  13. What steps are required to dissolve a sole proprietorship?
  14. What Internal Revenue Service forms are required in order to track profits and losses from a sole proprietorship?
  15. What are some of the sole proprietor's concerns when hiring employees?
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## eLecture: Review Answers

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Applying Concepts

Chapter Review


**eLecture: Review Answers**

Reflection

Reflection Responses

Chapter Quiz

### eLecture: Review Answers



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### ***Narration Script***

1. Explain why a sole proprietorship is simple to create and maintain.  
The sole proprietorship is the easiest type of business to create because it has very few notations in regard to registrations or other filings with the state. Essentially, a person decides to go into business for himself or herself and then begins conducting business.
  2. What tax advantages does a sole proprietorship offer?  
A sole proprietorship offers numerous tax advantages, including the ability to "pass through" business losses on the individual owner's income tax filings. Of course, the opposite is also true, and the owner must declare profits from the business on the individual income tax as well.
  3. What are some of the financial concerns facing sole proprietors?  
There are numerous financial concerns in running a small business, including how to finance it, how to acquire necessary equipment, and how to keep the
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business running in the face of competition and creditors.

4. What organizational steps must a sole proprietor go through in order to begin his or her new business?

There are actually very few organizational steps that a sole proprietor must go through in order to begin running a new business. Obviously, the more prepared and organized the business owner is, the greater his or her chance of success, but as far as state filings, there are very few.

5. Explain the cash flow arrangement in a sole proprietorship.

In a sole proprietorship, there is no distinction between the individual and the business. Business debts and profits are personal debts and profits. This can be a great advantage when the business is doing well but can be a tremendous hardship when the business fails.

6. The text mentions that sole proprietors have complete control over their businesses but also shows that there are some practical limitations. Discuss these limitations.

Some of the important limitations placed on sole proprietors concerns the basic cash flow arrangement. Although they have great flexibility in the type of business that they can run, because they have little financial resources and can only borrow based on their personal credit histories, they often face financial shortfalls and undercapitalization that eventually cause the business to fail.

7. Describe the tax advantages of sole proprietorships.

In a sole proprietorship, the owner can pass through business losses on his or her individual income tax return.

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8. Why are the time and personal commitments considered to be disadvantages in the sole proprietorship?

Time in personal commitments are many in creating and running a business, and because there is only a single individual to conduct the business, sole proprietors generally have little time for vacations or even days off.

9. Why is it difficult for new businesses to obtain financing and credit?

Most banks and other lenders know that new businesses frequently fail and that they are a risky investment. As a result, most lenders will not extend credit to a new business until it has a proven track record of two or three years.

Unfortunately, in order to last that long, the business must have financing and therefore is caught in a classic "catch-22" situation.

10. One of the disadvantages of a sole proprietorship is the fact that it has limited existence. What does this phrase mean?

Because a sole proprietorship is interchangeable with the individual who runs it, when that individual dies or is otherwise incapable of carrying on the business, it ceases to exist.

11. Explain the personal liability that a sole proprietor has in his or her business.

Sole proprietors face unlimited personal liability for all business debts and judgments assessed against the business.

12. Is it possible to sue a sole proprietorship after the owner is dead? Explain.

As one of the cases in this chapter clearly demonstrates, a civil action against a sole proprietorship must be dismissed on the death of sole proprietor.

13. What steps are required to dissolve a sole proprietorship?

Dissolving a sole proprietorship is relatively easy process and simply involves the business owner's decision to stop all operations and pay off any outstanding debts.

14. What Internal Revenue Service forms are required in order to track profits and losses from a sole proprietorship?

Internal Revenue Service requires Form 1040, Schedule C, for the reporting of profits and losses from an individually owned business.

15. What are some of the sole proprietor's concerns when hiring employees?

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When a sole proprietor hires employees, he or she must comply with Internal Revenue Service requirements for withholdings from the employee's pay as well as Social Security and workers' compensation payments.



## Reflection



**Reflection**

1. What, in your opinion, is the biggest advantage of being a sole proprietor? What is the biggest disadvantage?
2. Statistics show that most new businesses fail in their first year. Why? Is it because of lack of finances, poor management, or some other reason? What is your opinion?

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# Reflection Responses



The screenshot shows a software interface with a sidebar on the left containing six buttons: 'Applying Concepts', 'Chapter Review', 'eLecture: Review Answers', 'Reflection', 'Reflection Responses', and 'Chapter Quiz'. The 'Reflection Responses' button is highlighted. The main content area is titled 'Reflection Responses' and contains the following text:

**Instructions: (Optional)** If you want, you may Email your responses to your instructor, making clear that your answers are for the *Reflection* segment of Chapter 3.

1. What, in your opinion, is the biggest advantage of being a sole proprietor? What is the biggest disadvantage?  
*Although your responses will vary, they should include references to the freedom and flexibility that being a sole proprietor brings. On the negative side, the owner's personal liability, time constraints, and inability to get financing would have to count as negatives.*
2. Statistics show that most new businesses fail in their first year. Why? Is it because of lack of finances, poor management, or some other reason? What is your opinion?  
*Your responses will vary and you will draw on your own experiences.*

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## Chapter Quiz

Business Organizations & Corporate Law: Chapter 3



A screenshot of a web application interface. On the left side, there is a vertical stack of six buttons with a dark blue gradient and white text. From top to bottom, the buttons are labeled: "Applying Concepts", "Chapter Review", "eLecture: Review Answers", "Reflection", "Reflection Responses", and "Chapter Quiz". The "Chapter Quiz" button is highlighted with a lighter, brownish-gold gradient. To the right of this sidebar is a main content area with a white background and a thin border. At the top of this area, the text "Chapter Quiz" is displayed. Below it, there is a single blue hyperlink that reads "Click here for the Chapter Quiz." The entire interface is set against a dark grey background.

### ***Tab Text***

[Click here for the Chapter Quiz.](#)

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