



Missouri

Ag Law Brief

Sole Proprietorships

Every business owner made a decision regarding the type of business entity they would use when they started their business. That decision may have been to operate as a Sole Proprietorship, Partnership, Limited Liability Company, or some type of Corporation. Entrepreneurs recognize that this decision needs to be reevaluated as the business grows or the business environment changes. An additional complexity involved in the reevaluation of this decision comes in recognizing that the criteria used in making the initial decision have likely changed over time as the business has grown, as the family has grown, and as the marketplace has changed.

There are several groups of criteria which entrepreneurs might consider in deciding whether or not a transition in the business entity type is wise. These categories include: Management characteristics such as who should own what assets? Who should control the decision-making process? Who should benefit from the success of the business? Who should carry the various risks inherent in the business? Of course, the answer to each of these questions may involve a number of people, but the decision then becomes how to allocate, for example, the business risk, and how that allocation might change over time based on established milestones.

Another category of issues to consider in identifying or transitioning business entities is related to estate and business transfer planning. Finally, the impact of taxes on the overall business as well as individual owners needs to be considered in determining the best

business entity structure. The outline below describes some of the characteristics of Sole Proprietorships as they relate to the criteria entrepreneurs consider in choosing a business entity.

How is this entity legally formed?

External documents

1. A Sole Proprietorship does not need to be registered with the state.
2. There are generally no formalities required in forming a Sole Proprietorship. However, Missouri Law requires anyone doing business under a name other than their true name must register the name of the business, referred to as a "fictitious name", with the Secretary of State's office.
3. When a Sole Proprietorship is formed the owner and the Sole Proprietorship are a single legal entity, legally indistinguishable.
4. The existence of the Sole Proprietorship need not be reported to the Internal Revenue Service or the Missouri Department of Revenue upon formation. Income and expenses for the Sole Proprietorship are transferred to the owner's personal tax returns which may be these agencies first knowledge of the Sole Proprietorship's existence.



Internal documents – none required

1. Who receives the income stream? All income from a Sole Proprietorship goes to the owner of the business.
2. Who has decision rights?
 - a. Management decisions are reserved for the owner to delegate.
 - b. Financial decisions are reserved for the owner to delegate.
3. Who is liable, and to what extent/proportion, for debt and legal claims against the business for the acts of owners, employees, contractors?
 - a. A Sole Proprietorship and the owner of that business are one and the same legal entity.
 - b. The owner is inseparable from the Sole Proprietorship, so she is personally liable for any business debts.
 - c. All liabilities, debts, financial obligations, and legal claims against a Sole Proprietorship can be claimed against the personal assets of the owner if the assets of the business are insufficient.

Agency

Any person, whether or not a paid employee of the Sole Proprietorship, who is “held out” as having authority to make purchases or other obligations on behalf of the business, may be held to have legally bound the Sole Proprietorship to an obligation even if the owner of the business did not expressly give that person authority to make commitments on behalf of the Sole Proprietorship. The business can be declared to have been “Holding Out” a person as an

agent of the business by giving the impression to a third party that the business has authorized this person to act on behalf of the business.

Consider a high school student who works on a neighbor’s farm after school and frequently stops by the local Cooperative to pick up some needed tractor parts or animal feed at the direction of the farm owner who has also authorized the student to charge the purchases to the farm account and the Cooperative has always been promptly paid for those purchases when the farm was invoiced. One day the student buys a few bags of horse chow for his personal horse and charges it to his farm employer’s account. When the Cooperative has no way to know the student was no longer authorized to make charges to the farm account the farm employer may be liable for those charges even though the horse feed was for the personal use of the employee and even if that student no longer worked on the farm.

The “Agent” concept protects the Cooperative because from their perspective the employee had been authorized to charge animal feed products to the farm business account. The farm owner had been “holding out” the student worker to the Cooperative as an authorized agent of the farm business to make such purchases. How were they to know that a particular purchase of horse feed was not authorized when that student had made so many purchases before that could reasonably be related to the farming operation or that the student was no longer working on the farm? The “holding out” concept only applies, in this example, to the Cooperative where the student had been making similar purchases and does not extend to other businesses where the student worker may stop and try to charge



purchases to the farm account where he had never before made purchases on behalf of the farm business.

Tax Treatment of Income and Losses

1. The income and expenses from a Sole Proprietorship are generally treated as individual income on the owner's personal income taxes.
2. A Sole Proprietorship is not a separate legal entity from the owner for tax purposes.
3. The Sole Proprietorship does not pay income tax separately from the owner. The owner reports business income or losses from the Sole Proprietorship on his/her individual income tax return.

Dissolution

1. When the owner of a Sole Proprietorship decides that that business should no longer operate, or the owner dies, the legal existence of the Sole Proprietorship ends.
2. However, because the Sole Proprietorship and the owner are the same legal entity, any remaining liabilities, financial obligations or legal claims which come against the now dissolved Sole Proprietorship may be applied directly to the owner's estate.
3. The owner of a Sole Proprietorship should make sure that any businesses with which it has done business in the past understands that that Sole Proprietorship no longer exists and that neither the owner nor anyone who had been previously "held out" to have

actual or implied authority to make commitments on behalf of that Sole Proprietorship has the authority to make any further commitments on behalf of the business.

4. When the owner of a Sole Proprietorship dies, the Sole Proprietorship is immediately dissolved.
5. Someone else in the family may decide to promptly start a new Sole Proprietorship with the same company name and effectively doing the exact same things as the old Sole Proprietorship.
6. Remember, the old Sole Proprietorship and the now deceased owner were legally one and the same entity. Neither one legally exists after the death of the owner.
7. When the "new" Sole Proprietorship begins to operate as a business, the new owner and the new Sole Proprietorship are now legally one and the same entity.



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