**8760. How is a sole proprietorship taxed?**

Legally, a sole proprietorship is not an entity separate from its owner (see Q 8759). As a result, for tax purposes, the proprietor and the enterprise are treated as one indivisible unit. The proprietorship, as such, is not a tax paying entity.

The proprietor reports income and expenses on an individual return (Form 1040). For this purpose, a separate Schedule C is filed, including total proprietorship receipts, inventory, costs, and deductions, to arrive at proprietorship net profit or loss. This net profit or loss from Schedule C is carried to Form 1040, and included in taxable income.[[1]](#footnote-1)

In addition to the regular income tax applicable to the proprietorship net income, the Schedule C net income is also subjected to a separate self-employment tax (on Schedule SE), which is intended as a substitute for the Social Security taxes which would have been imposed if the income had been salary or wages paid by an employer (see Q 8533 and Q 8536). Since a sole proprietor is, in effect, both employer and employee, the self-employment tax encompasses both the employer and employee portions of the Social Security taxes on wages.

The estate of a sole proprietor is treated in the same manner as the estate of any other decedent. Unless specific assets pass by trust, contract or survivorship, they will be included in the proprietor's estate and potentially subject to estate taxation. Since the proprietor's business is not a separate entity, the business assets and liabilities also are subject to the estate administration process. This can be of a particular concern if the estate owns some assets which may be risky from a liability perspective.

A “qualified joint venture” that is carried out by a husband and wife may elect to treat their business as two sole proprietorships and not as a partnership for tax purposes. A qualified joint venture is any joint venture conducting a trade or business where the only owners are two spouses, both spouses materially participate in the business, and both spouses elect to opt out of the partnership taxation rules. Items of income, gain, loss, deduction, and credit must be divided between the spouses according to their respective interests in the business.[[2]](#footnote-2) See Q 8764 to Q 8775 for a discussion of the tax treatment of partnerships.

1. . See IRS Guidance on Sole Proprietorships, available at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Sole-Proprietorships (last accessed June 5, 2014). [↑](#footnote-ref-1)
2. . IRC Sec. 761(f). [↑](#footnote-ref-2)