**Forming a Sole Proprietorship**

Whether you're starting a business from home or opening a large-scale operation, you'll need to decide on the best legal structure for your new company. Don't underestimate the importance of your choice, as the legal entity you choose will affect how much personal liability you face, how much you pay in taxes and how in- depth your new company's record keeping will need to be. Your business structure can take one of five basic forms: the sole proprietorship, the partnership, the regular or C corporation, the S corporation, and the increasingly popular limited liability company or LLC.

The best entity for you will depend on the type of business you'll run, your potential exposure to lawsuits, the number of owners and whether you want the ability to raise capital or transfer shares. It's smart, and in many cases necessary, to consult a lawyer or accountant when making your choice. You may also take advantage of a number of resources available on the Internet, including LegalZoom.com and Nolo.com, which offer legal forms and do-it-yourself kits at reasonable prices.

In coming weeks, we'll delve into more details on each structure, starting with sole proprietorships.

**Sole Proprietorships**

The vast majority of small businesses start off as sole proprietorships, which are the simplest and least expensive vehicles to create and operate, according to the SBA. With a sole proprietorship, the owner and the business are essentially one and the same, meaning you have complete control, you can make decisions as you see fit and the profits from the business flow through to your personal tax return as Schedule C income. (If you don't have profits, you may be entitled to a business loss that can help offset other income.) To launch a sole proprietorship, you don't need to file legal forms or paperwork, such as articles of incorporation, but you might have to obtain a business license, depending on state law. (See related story "[Do I Need a Business License or Permit?](http://online.wsj.com/articles/SB10001424052748704888404574547953011869912)") A sole proprietorship can only be used by an individual who owns the company, unless it's a husband- and- wife team, in which case it can be shared.

[Liability is always a concern, so I minimize risk as best I can by focusing on quality product and quality business partners. And I intend to buy insurance.](http://online.wsj.com/news/articles/SB10001424052748704625004575089691123329772?mod=WSJ_hps_MIDDLESixthNews#articleTabs%3Dcomments)

—Steve Bonomo

The main drawback of setting up a sole proprietorship is that you have unlimited personal responsibility for all debts or judgments related to the business. That liability, in turn, may make it difficult to attract investors or raise funds for your business.

As a sole proprietor, you'll also be responsible for paying the full burden of Social Security and Medicare taxes— a cost normally split between employer and employee. For 2010, the first $106,800 of self- employment income is taxed at 12.4 percent for Social Security and 2.9 percent for Medicare. Any amount over $106,800 continues to be taxed at 2.9 percent for Medicare only.