Conducting business as a sole proprietor is one of the simplest forms of operation. It's easy to start a business operated as a sole proprietorship and equally easy to discontinue.

Getting started

- If you plan on hiring employees, you'll need to obtain an employer identification number (EIN) by filing Form SS-4, *Application for Employer Identification Number*, with the Internal Revenue Service. If you do not hire employees, you may use your social security number for filing purposes.
- Open a separate checking account for your business. It will be easier to track your deductible expenses if they aren't commingled with your personal expenses.
- If you incurred expenses prior to opening your business, keep them separate from your other expenses. Special tax treatment applies to start-up expenses. These expenses include: conducting a survey for potential markets, products, or labor; advertising the opening of your business; salaries and wages for training new employees; travel and other necessary costs for securing prospective distributors, suppliers or customers.

Purchasing equipment

Equipment that you purchase for your business is generally depreciated over its class life. In most cases, this is either five or seven years. It is important to keep accurate records of the cost of your equipment and the date of purchase for each piece.

For equipment purchased in 2014, the IRS allows you to deduct up to $500,000 of the cost in the year you place the asset in service. For 2015, this amount is reduced to $25,000. This applies to used equipment as well. However, the IRS does not allow you to expense equipment that you purchased from a related party or equipment that you converted from personal use.

Making estimated tax payments

As a sole proprietor, the IRS requires you to make quarterly estimated tax payments. If you don't, you may be subject to late-payment-of-tax penalties. The IRS requires you to make estimated tax payments if any of the following apply:

- The total tax shown on your return, less the amount you paid through withholding (if you were also a wage earner), is more than $1,000.
- You expect your withholding and credits to be less than the smaller of: (1) 90% of the tax shown on your current return; or (2) 100% of the tax shown on your prior year's return, 110% if adjusted gross income from the prior year exceeds $150,000 ($75,000 for married filing separate). Your prior year's return must cover a full 12 months.
- Estimated tax payments are generally due on April 15, June 15, September 15 and January 15.

Hiring employees

Having employees work for you requires some additional paperwork and recordkeeping. For each employee you must:

- Obtain a valid social security number.
- Have each employee fill out Form W-4, *Employee's Withholding Allowance Certificate*.
- Have each employee fill out Form I-9, *Employment Eligibility Verification*.

You may hire your spouse or children to work for you, but you must treat them as bona fide employees and pay them reasonably in order to take a deduction for their wages.

Home office deduction

The IRS allows self-employed taxpayers to claim a deduction for home-based business expenses if they meet certain requirements:

- They must use the home office regularly and exclusively as: (1) the principal place of business for a trade or business; and (2) a place to meet with clients, patients or customers in the course of the trade or business (or in connection with the taxpayer's trade or business) if the location is in a separate structure not attached to the dwelling unit.
- The IRS may allow a deduction for inventory storage if the product is regularly sold to others and there is no other fixed location available for the business.

Home office calculations

There are two ways to calculate your home office deduction. The simplified method uses a standard deduction. If you maintain a qualifying home office, you may elect to deduct annually $5 per square foot of home office space up to 300 square feet, for a maximum deduction of up to $1,500. If you choose this method, depreciation is not allowed for a portion of your home; however, you can claim allowable mortgage interest, real estate taxes and casualty losses on the home as itemized deductions on Schedule A. These deductions need not be allocated between personal and business use, as is required under the regular method. Business expenses unrelated to the home, such as advertising, supplies and wages paid to employees are still fully deductible.

Otherwise, you may calculate your deduction using the actual expense method. When making home office calculations, consider direct and indirect expenses.

Direct expenses are those that pertain exclusively to the home office, such as painting the walls or installing new carpet.

Indirect expenses are those that pertain to the entire residence, such as rent, mortgage interest, taxes, insurance, repairs, utilities, casualty losses and depreciation. Allocate indirect expenses between the business and nonbusiness portions of the home. The most accurate method of allocation is to divide the square footage of the office by the total amount of usable space in the home. If rooms are of approximately equal size, you can divide the number of rooms used for business by the total number of rooms.

The home office deduction is limited to the amount of net self-employment income prior to the home office deduction. Any disallowed home office deduction is carried forward to future years. See your tax professional for additional guidance.

Starting a retirement plan

As a self-employed taxpayer, the IRS treats you as the employer *and* employee. Generally, if you start a retirement plan and make contributions for yourself, you must make contributions for all your employees. There are several types of retirement plans that you can set up for your business. Some of the more common types are:

- A Simplified Employee Pension (SEP). You have until the due date of your return (plus extensions) to set up and make contributions to the plan.
- A Savings Incentive Match Plan for Employees (SIMPLE). This type of plan must initially be set up by October 1, with contributions allowed up until the due date of your return (plus extensions).
- SIMPLE 401(k). This plan is a cash or deferred arrangement allowing employees to make pre-tax salary deferrals.
- Keogh.

This is not an all-inclusive list of eligible retirement plans, nor is it intended to provide details on each plan and the requirements that apply to each plan. Seek the advice of your tax professional before choosing the plan that is right for you.

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