CPA Practice Advisor

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Nellie Akalp • Mar. 10, 2019

There are several reasons your clients may want to switch entities in the course of their business lives. When they started their businesses, a Sole Proprietorship may have been the default selection, but over time your client may need more protection from liabilities, want to offer stock or go public. Knowing what to advise them in this situation is important to retaining them as clients and your firm’s reputation.

In some states, entity change is as simple as filing a document with the Secretary of State. In other states, your client may need to dissolve the original business and change the company name. Although the steps are not difficult there are still some important factors to warn your clients about. Plus, changing to a new entity type can

Next, your clients should file the appropriate formation documents with their states, such as Articles of Organization for LLCs and Articles of Incorporation for corporations. These documents describe the business's organization, define business activities and detail the responsibilities of board officers and members. Your clients must also obtain a new Federal Tax ID or Employer Identification Number (EIN) from the IRS. This can be filed online or printed out and mailed in by using Form SS-4.

The client will need to set up new bank accounts, vendor accounts, invoices, etc. in the new business's name. Remind them to separate personal and business bank accounts to protect their personal assets from liability, and make sure they're aware of the double taxation that C Corporations face.

C Corporation to an S Corporation

If your client doesn't like the double taxation of a C Corp but still wants liability protection, suggest they file as an S Corp so they can pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Clients must file IRS Form 2553 by March 15. If they miss this deadline, the business will be taxed as a C Corp until the next tax year unless your client gets an extension to file as an S Corp by filing IRS Form 7004.

LLC to a C Corporation

Many clients switch from an LLC to a C Corp so they can sell stock and/or attract investors. A corporation can sell stock or shares, with an unlimited number of shareholders, and can offer employees stock options. Plus, if your client ever plans to go public, the business must be structured as a C Corp.

First, all members of the LLC must agree to change business structure. Then, follow the corporate laws in the state the LLC is registered. In states that allow a "statutory" conversion, a document is filed with the state filing office to change from one entity

Changing from a C Corp to an LLC could make your client happier in the long run (less paperwork and a more flexible organization structure), but the transition won't be an easy one. The IRS considers this switch a monetary transaction, meaning your client "sells" the assets of the C Corporation and is taxed on any assets that have appreciated in value. Remind your clients that LLCs are not as attractive to outside investors as C Corps and that switching back to a C Corp would be time consuming and cumbersome.

No business structure is set in stone. Your clients will have different needs as their businesses grow, so review all their options before embarking on an entity conversion.

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Nellie Akalp is a passionate entrepreneur, business expert and mother of four. She is the CEO of CorpNet.com, a trusted resource and service provider for business incorporation, LLC filings, and corporate compliance services in all 50 states. Nellie and her team recently launched a partner program for accountants, lawyers, and business professionals to help them streamline the business incorporation and compliance process for their clients.

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