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Nellie Akalp • Jul. 13, 2022



This is part one of a series on business conversions. [Click here to read part two.](#)

Business change is constant, so it wouldn't be surprising if, at some point, your clients considered changing their legal structures. In this first *Conversion Series* post, we'll explain how to help your clients change from a limited liability company (LLC) to a C Corp and vice versa. There are several reasons your clients may want to switch from an LLC to a C Corp or the other way around. While both legal entities protect business owners from personal liability from the company's debts and lawsuits, they differ in ownership structures and tax consequences.

LLC Management Structure

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with the Secretary of State. Although the details required in Articles of Organization vary by state, in general, the following information is included:

- LLC Name
- Statement of Purpose
- The physical address of the LLC's principal place of business
- Mailing address
- LLC's management structure (i.e., member-managed or manager-managed)
- Registered agent's name and address
- LLC's organizers' names (and managers, if applicable)
- Effective date requested

A registered agent is the member of the LLC that's the official contact responsible for the LLC's legal correspondence. LLCs doing business in a state other than their home state must name a registered agent (a person or company) that agrees to accept legal papers on the company's behalf.

In addition, most LLCs create a formal Operating Agreement that documents the logistical details of the company, such as who is responsible for what, how to file taxes, what happens to the business if a member wants out, etc. Although not required by the state, it is highly advisable to have a set plan for contingencies, even in a single-member LLC. Operating Agreements also provide further proof the business runs as a separate entity, which is essential for the liability factor.

Finally, an LLC may be required to file an Annual Report with the state to notify the government of any changes of address or personnel within the company.

C Corp Management Structure

Business owners of a C Corp are considered shareholders and employees of the corporation. Shareholders/owners work for the corporation and receive a salary and

W2s. In a C Corp, the owners must form a Board of Directors to oversee the

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Like the LLC, a C Corp must create and submit Articles of Incorporation (sometimes called a “certificate of incorporation”). Once the state approves the company’s Articles of Incorporation, the business is officially considered a separate legal and tax-paying entity from its owners. Again, the information required in the Articles of Incorporation varies by, but in general, includes:

- Corporation’s name
- Address of the corporation’s principal office
- Name and address of the corporation’s registered agent
- Business purpose
- Whether the corporation is organized on a stock or non-stock basis
- If stock basis: the initial classes of stock, number of authorized shares, and par values of shares
- Name and address of each incorporator
- Name and address of each member of the initial board of directors
- Effective date requested

The C Corp may also be required to file corporate bylaws (similar to the Operating Agreement) and an annual report with the state to keep the government apprised of any significant corporation changes.

Differences in Taxation

Although separated legally, LLC members and the company are (by default) considered the same tax-paying entity by the IRS. The LLC’s profits and losses pass through to the owners’ personal income tax returns. Also, all profits are subject to self-employment taxes (Medicare and Social Security).

In a C Corp, where the business owners are company employees, the corporation is a separate tax-paying entity. When the C Corp makes a profit, it is taxed on that

income. Then, the business owners are taxed on the portion of business income that

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a C Corp.

However, LLCs can file taxes as C Corps and not have the company's profits pass through to their personal tax returns. For LLCs keeping a substantial part of their profits in the business (retained earnings), electing to be treated as a C Corp allows for paying lower salaries and fewer taxes.

Alternately, LLCs and C Corps can elect to be taxed as S Corporations. S Corps are corporations electing to pass corporate income, losses, deductions, and credits to their shareholders for federal tax purposes. The S Corp election allows shareholders/owners to avoid double taxation and potentially pay less in payroll taxes by dividing income into wages and dividends. However, not all LLCs can elect S Corp taxation. Companies must:

- Be a domestic corporation
- Have only allowable shareholders:
 - Can be individuals, certain trusts, estates and
 - All shareholders must be U.S. citizens
- Have no more than 100 shareholders
- Have only one class of stock

To become an S Corp, the corporation must submit [Form 2553 Election by a Small Business Corporation](#) signed by all the shareholders.

So far, the reasons for converting from an LLC to a C Corp or vice versa can be attributed to management organization and some tax benefits. However, the primary reason your client may want to convert business structures is the difference in investment opportunities.

Investment Differences

For many business owners attracting more investors is critical to their company's

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The LLC's Operating Agreement must record each member's capital investment in the company. Unless otherwise stated, the Internal Revenue Service assumes the investment percentage proportions of profits and ownership. However, LLCs are granted the flexibility to proportion profits and ownership as they like; for example, more may be attributed to active members. Passive members are not required to pay self-employment taxes on their share of the profits.

Conversely, C Corps can sell unlimited stock or shares, including offering employees stock options. If your client plans to take the company public or offer employees equity in the business, the company must be structured as a C Corp. Investors typically prefer to put money into a C Corp because of the opportunity for growth, the lack of taxation on business income, and the protection from personal liability.

Steps for Structure Conversion

The process for an LLC to convert to a C Corp or vice versa varies by state. However, in most states, the corporations can file a "Statutory Conversion." In states that allow statutory conversions, the procedure is as follows:

- Create a plan of conversion, which must be approved by all LLC members and shareholders
- File a certificate of conversion and Articles of Incorporation/Organization
- Pay the filing fee

In some cases, the state may require the company to obtain a new Federal Tax ID Number or EIN (Employer Identification Number). If the state doesn't allow statutory conversions, the LLC or C Corp must dissolve the company and start the corporation from scratch. Dissolution requires assets and liabilities to be "dissolved" and reformed. If the state allows, a "Statutory Merger" can help keep the LLC from starting over.

In a statutory merger, the members approve a merger plan and swap their allocated

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Your clients have much to consider before converting their business structure. But with your guidance, a change may open the door to additional opportunities to help their companies grow.

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Nellie Akalp is a passionate entrepreneur, small business expert, and mother of four. She is the CEO of [CorpNet.com](https://corpnet.com), a trusted resource for Business Incorporation, LLC Filings, and Corporate Compliance Services in all 50 states. Nellie and her team recently launched a partner program for accountants, bookkeepers, CPAs, and other professionals to help them streamline the business incorporation and compliance process for their clients. More info at: [CorpNet.com/partners](https://corpnet.com/partners).

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