



# Transitioning from a Sole Proprietorship to an LLC or a Corporation

What You Need to Know



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# What

## Defining small business structures

### Sole Proprietorship vs. Limited Liability Company vs. Corporation

A [company's business structure](#), often called a business entity, defines how it's classified, regulated and taxed by the federal and state governments. It may also determine how small business owners handle day-to-day operations, from managing payroll to maintaining bookkeeping.

Learn how a sole proprietorship compares to a limited liability company and a corporation.

### Sole Proprietorship Overview

A business that is owned and operated by one individual is a sole proprietorship. As an unincorporated business, there is no legal distinction between the owner and the company itself. That means the owner retains full control over decisions, operations and profits but also assumes all associated business risks. Because the owner and the business are legally the same, any debts, obligations or legal actions may directly impact personal assets.

From a tax standpoint, a sole proprietorship is considered [a pass-through entity](#): Profits and losses flow to the owner's personal tax return via Form 1040, Schedule C. Eligible business expenses may be deducted, potentially reducing overall taxable income (and the amount of estimated tax owed).

### Advantages of a Sole Proprietorship

- **Simple setup and minimal cost.** Sole proprietorships don't have to be registered with the state, though there may be local business license or permit laws to comply with to make the business legitimate.<sup>1</sup>
- **Full control and flexibility.** The owner makes every business decision and may quickly adapt to creative, market or operational changes.
- **Direct profit and taxation.** All earnings are taxed at the personal level, helping owners avoid filing a separate business tax return and paying corporate income tax.

### Disadvantages of a Sole Proprietorship

- **Unlimited personal liability.** Because the business and owner are one entity, personal assets may be at risk in the event of business debts or damages.
- **Limited access to capital.** Financing opportunities often depend on the owner's personal credit, which may make it more difficult to raise funds or attract investors.
- **No continuity.** The business typically ceases to exist after [the sole proprietor retires](#) or passes away, which may complicate transfer plans.



## Limited Liability Company Overview

A [limited liability company](#) blends characteristics of both sole proprietorships and corporations, offering flexibility in ownership and management. Unlike a sole proprietorship, which has a single owner, an LLC may include multiple members who share decision-making and profits.

Each state sets its own rules for LLC formation, so requirements may vary.<sup>2</sup> Generally speaking, LLCs may be structured as single-member or multi-member entities. By default, a single-member LLC is taxed as part of the owner's personal return, while multi-member LLCs are taxed as partnerships. Some industries, such as banking and insurance, are not eligible to operate as LLCs.

### Advantages of an LLC

- **Flexible taxation.** Like they do in a sole proprietorship, profits and losses typically pass through to members' personal tax returns, helping to avoid corporate-level taxation.
- **Limited liability protection.** LLCs create a clear legal boundary between personal and business assets, which may help shield owners from certain debts or legal claims.
- **Easier access to financing.** The separation of personal and business finances may [simplify credit or loan applications](#), as lenders will not assess personal credit history alongside the business's financial standing.

### Disadvantages of an LLC

- **Added administrative and financial responsibility.** LLCs require formal registration, ongoing state filings and accurate record-keeping to remain in good standing.
- **Potential for higher taxes.** LLC members are typically responsible for self-employment taxes, which may increase personal tax liability.
- **Variable liability limits.** While LLCs usually hold personal and business assets separately, courts may pierce the corporate veil in cases of fraud or commingled finances (more on liability protection and compliance to come).

## Corporation Overview (C-Corp and S-Corp)

A corporation is a distinct legal entity that is separate from its owners and shareholders. It may earn profits, pay taxes and be held legally liable, providing the strongest degree of separation between personal and business assets. Because of this independence, a corporation continues operating even if ownership changes, which may help offer small businesses long-term stability and scalability.

Small business corporations typically fall under two brackets:

**1) A C corporation (C-Corp) is the standard business model, and it is taxed separately from its shareholders.** Profits are subject to corporate income tax, and dividends — the portion of profits paid out to shareholders — are taxed again at the personal level. This process is often referred to as “double taxation.”

**2) An S corporation (S-Corp) is designed to help avoid double taxation.** It allows profits and certain losses to pass directly to shareholders' personal tax returns, which may eliminate corporate-level tax in most cases. A business must meet specific IRS requirements to qualify for S-Corp status, including limits on shareholders, stock classes and business type.<sup>3</sup> Some states treat S-Corps differently for tax purposes, so it's vital to verify local rules.<sup>3</sup>

### Advantages of a corporation

- **Strong liability protection.** Shareholders' personal assets are generally separate from corporate debts or obligations.
- **Access to financing.** Corporations may issue stock to attract investors and raise funds, plus a formal structure may help attract partners and future buyers.<sup>4</sup>
- **Continuous operations.** The corporation may continue operating, regardless of changes in ownership or leadership.

### Disadvantages of a corporation

- **More administrative work.** Corporations must follow strict payroll, reporting and record-keeping requirements to maintain regulatory compliance.
- **Additional costs and taxation.** Registration, legal and accounting expenses are often higher, while C-Corp profits may be taxed at both the corporate and the shareholder levels.
- **Ownership restrictions for S-Corps.** Shareholder and stock limitations (no more than 100 shareholders, only one class of stock) may reduce flexibility compared to other structures.<sup>3</sup>

# When

## Deciding when to transition your business

### Signs Your Sole Proprietorship Has Outgrown Its Structure

A sole proprietorship may be an ideal starting point for many entrepreneurs, but it may also be just that: a starting point. Over time, the same qualities that made a sole proprietorship appealing — such as direct control and individual autonomy — may begin to limit long-term growth.

As [Shana Peterson-Sheptak](#), PNC Bank's head of Business Banking, explains, "Before you land on a corporate structure, ask the question, 'How big can my company ultimately become?' ... If you grow as a sole proprietorship and expand your team or have substantial vendor relationships, things become far more complicated. Those demands could require an entirely new structure."

While every business grows at its own pace, certain developments may signal that your sole proprietorship has outgrown its structure.

### Increasing Revenue or Contracts

A steady rise in revenue, long-term contracts or higher-value clients may indicate it's time to reassess your structure. Greater income often brings larger tax obligations and greater legal exposure that may make formal incorporation beneficial for managing risk.

### Growing Personal Liability Exposure

Speaking of greater legal exposure, as customer value, contracts or assets increase, so does the potential for legal claims. Establishing a business entity with limited liability may help protect personal assets and provide peace of mind as your small business expands.

### Hiring Employees

On the topic of expansion, adding employees introduces new responsibilities such as payroll, benefits and compliance. For some business owners, forming an LLC or a corporation may help simplify tax reporting and create a clearer distinction between personal and business liabilities.

### Taking on Debt or External Investors

Beyond scaling your team, financing business growth through loans or outside investors may shift both financial and legal obligations. A formal structure may make it easier to separate personal and business credit, meet lender requirements, and attract new shareholders.



### Gauging Your Emotional and Strategic Readiness for Change

Recognizing the logistical signs of growth is one thing, but feeling ready to act on them is another. While transitioning from a sole proprietorship to a more formal structure may bring new confidence, it may also introduce new responsibilities. Taking time to assess your comfort level with task delegation and shared decision-making may help confirm that the change aligns with your goals.

Strategically, it may also be helpful to evaluate your long-term vision — or how big you'd like your business to become and what resources you'll need to get there — with a [trusted business or financial advisor](#). When the idea of expansion begins to feel more necessary than nerve-wracking, it could potentially signal that your business, and you as an owner, may be ready for the next step.

### Tax Considerations When Scaling Your Small Business

As your business grows, [how it's taxed may change](#) — especially if you transition from a sole proprietorship to an LLC or a corporation. Key considerations include:

- **Pass-through taxation.** Sole proprietorships and most LLCs report business income on the owner's personal tax return. Profit and losses "pass through" to the individual, simplifying reporting but potentially increasing personal tax liability.
- **Corporate taxation.** C-Corps are taxed as separate legal entities. The company pays corporate tax on its profits, while shareholders pay personal tax on any dividends received.
- **Double taxation.** Because dividends are not tax-deductible for C-Corps, the same profits may be taxed twice: once at the corporate level and again when distributed to shareholders.
- **Flexibility in taxation.** Multi-member LLCs taxed as partnerships and S-Corps both use pass-through taxation, allowing profits to be reported on owners' personal returns and helping to avoid double taxation that applies to traditional C-Corps.



# Why

## Selecting between an LLC and a corporation

### How Do LLCs, C-Corps and S-Corps Stack Up?

Characteristic	LLC	C-Corp	S-Corp
<b>Ownership</b>	Unlimited members with a flexible ownership structure	Unlimited shareholders, can issue multiple stock classes	Up to 100 shareholders, only one class of stock
<b>Liability</b>	Members generally protected from personal liability for business debts	Separate personal and business assets, shareholders generally protected from personal liability	Separate personal and business assets, shareholders generally protected from personal liability
<b>Taxation</b>	Pass-through taxation with profits reported on members' personal returns	Separate entity taxed at the corporate and shareholder levels (double taxation)	Pass-through taxation with profits reported on shareholders' personal returns
<b>Management</b>	Less formal, can be member-managed or manager-managed	Structured with directors, officers and formal governance	Structured with directors, officers and formal governance
<b>Compliance and Cost</b>	Moderate setup cost: ongoing state filings	Higher setup and compliance costs	Similar to C-Corp with additional IRS filing

### Which Aligns with Your Business Goals?

The right structure often depends on the future you envision for your business. For instance, LLCs may appeal to owners seeking operational flexibility, simpler tax reporting and fewer compliance requirements. Corporations, on the other hand, may suit owners looking to issue stock, raise external capital or prepare for an eventual sale.

### Should Industry Play a Role in Decision-Making?

Like future goals, industry might influence which structure feels the most appropriate for your business. Some industries, such as banking and insurance, are not eligible to operate as LLCs, whereas fields with higher regulatory oversight — such as healthcare or manufacturing — may benefit from the more formal structure of a corporation. Service-based or consulting businesses, however, may favor the flexibility and simplicity of an LLC.



# How

## Step-by-step process for transitioning

### 1. Planning and Preparation

Whether you're forming an LLC or incorporating your business as a C- or an S-Corp, proper preparation tends to make the process smoother. Before filing any paperwork, it may be helpful to consult with legal, tax or financial professionals who may be able to help clarify state-, structure- and industry-specific requirements. These conversations may also provide useful steps to minimize disruptions as your assets, contracts, vendors or accounts transition to a new entity.

As you plan your next move, consider discussing the following:

- **State-specific filing requirements.** Each state regulates LLCs and corporations differently, including naming rules, annual report schedules and filing fees.<sup>2</sup>
- **Business assets and contracts.** Identify any agreements, leases or property that may need to be transferred to your new entity.
- **Tax implications.** A tax or financial professional may help estimate potential filing changes or new tax obligations under your selected structure.

### 2. Registering a New Entity

Once your plan is in motion, the next step may involve formally creating a new business entity. Most states require registration through their business filing agency, which may differ depending on where you operate — for instance, Florida and New York businesses file through their state's Division of Corporations, while California and Colorado owners file through their secretary of state. Key registration steps may include:

- **Filing formation documents.** Submit Articles of Organization for an LLC or Articles of Incorporation for a corporation, along with the filing fee (if required), through your state's business filing office.
- **Selecting a registered agent.** Designate an individual 18 or older living in the same state as operations to receive legal and tax documents on behalf of your business. (Tip: A registered agent can be yourself or any other LLC or corporation member.)
- **Obtaining an Employer Identification Number (EIN).** Request a new EIN from the IRS to formally establish your business for tax and banking purposes.



### 3. Transferring Assets and Contracts

After registering your new entity, you may need to transfer certain assets, agreements and records to accurately reflect your updated business structure. This process often helps to provide continuity across your operations, as well as legally separate your personal and business activities. Steps to consider during the transfer process include:

- **Moving financial and insurance accounts.** Open new [business bank accounts](#) under your new entity and update related policies, such as property or liability insurance.
- **Reassigning contracts and agreements.** Update client agreements, vendor contracts and leases to list the new legal entity as the contracting party. (Tip: If your business has multiple owners, it may be useful to create or update an operating agreement to define each member's financial and management rights.)
- **Updating licenses and permits.** Notify local and state agencies of your new business entity to maintain compliance and avoid potential disruptions.

### 4. Closing Out the Sole Proprietorship

Once your new entity is active, you may need to formally close your sole proprietorship to maintain accurate records and prevent potential tax or compliance issues in the future. Taking a few proactive administrative steps may assist in a clean transition between the old and new structures. These final steps may include:

- **Filing final tax returns.** While there are no formal dissolution requirements, you must still report any remaining income or expenses for the sole proprietorship on your personal tax return.

- **Canceling your [doing business as \(DBA\) name](#).** If you choose to register a DBA that is separate from your legal first and last name, you must file a cancellation or abandonment form with the same office where it was registered.
- **Retaining financial and legal documentation.** Keep previous tax filings, bank records and business contracts for your files in the event they're needed for future reference.



# Financial implications of a business transition

## Managing Owner Compensation and Payroll Taxes

Transitioning to a new business structure often changes [how owners pay themselves](#) and handle payroll taxes. For example, S-Corp owners, unlike sole proprietors and LLC members, are no longer subject to self-employment tax on all income. Instead, they may pay themselves a “reasonable salary” as a W-2 employee, which is subject to FICA payroll tax (Social Security and Medicare).

What qualifies as “reasonable compensation” varies by industry and role. The IRS generally defines it as comparable to what another business would pay for similar services.<sup>5</sup> Remaining profits may then pass through to the owners’ personal tax returns and are subject to personal tax liability.

## Upcoming tax structure changes

Establishing an LLC or a corporation affects how business income is reported and taxed. While all businesses must file annual federal and state returns, pay quarterly taxes, and manage payroll or contractor payments, tax liability varies by structure.

- **Sole proprietorship:** Subject to self-employment and personal tax.
- **LLC:** Subject to self-employment and personal tax.
- **C-Corp:** Subject to corporate income and shareholder personal tax (on dividends).
- **S-Corp:** Subject to payroll and pass-through personal tax (on remaining profits).

## Timing the transition to minimize tax disruptions

Choosing when to transition may influence your overall tax liability. Some owners find that aligning the shift with the start of a new fiscal year may simplify recordkeeping and reduce the overlap between old and new filings.

## Updating Banking and Cash Flow Management

Opening new business checking and merchant accounts under your new entity name may help make accounting and tax reporting more straightforward. Likewise, financial partners like PNC Business Banking may also help streamline the transition through merchant services, payroll tools and treasury management solutions that improve cash flow visibility as your business scales.

## Upgrading Financing Growth Goals

Formalizing your business structure may enhance eligibility for financing and credit. Lenders often view LLCs and corporations as more stable entities, which may [expand access to small business loans](#), credit cards or lines of credit. Establishing strong banking relationships early in your transition may also help position your business for future growth and stronger financial flexibility.



# Shifting legal and compliance considerations

## Staying Up to Date with New Annual Requirements

As your business tax structure and financial outlook change, so may your ongoing compliance responsibilities. Compared to sole proprietorships, LLCs and corporations often face one-time, annual or continuous filing and recordkeeping requirements to remain in good standing.

## LLC Regulations to Consider

- Create and periodically update an operating agreement.
- Issue and document membership shares.
- Record all membership interest transfers.
- Hold annual member meetings and maintain written minutes.

## Corporation Regulations to Consider

- Hold and document annual shareholder and director meetings.
- Establish and maintain corporate bylaws.
- Issue stock and accurately record all transfers.
- File annual reports and financial statements as required by state law.

## Maintaining Liability Protection and Compliance

While LLCs and corporations offer far greater limited liability protection than sole proprietorships, maintaining that legal and financial shield requires ongoing effort. Mixing personal and business funds, failing to keep accurate records, or neglecting state filing obligations might “pierce the corporate veil” — a legal action where courts disregard a business’s limited liability and find the owners personally liable for the company’s debts and obligations.

Regularly reviewing compliance practices and working with legal counsel may help ensure that your entity remains in good standing, especially if your operations expand across state lines.



# Turning the page

## Transitioning team, vendors and customers

### Communicating Changes Internally

As you shift to a new business structure, remember that it's not just your entity making the transition — it's your employees too. Clearly explaining how the transition impacts payroll, titles or reporting may help reduce confusion and reinforce their confidence in leadership.

Similarly, it may be useful to review and update employee agreements, payroll systems and benefit packages to reflect your new business name and structure. Maintaining open, transparent communication often helps teams to remain aligned throughout the transition.

### Strengthening External Relationships

A transition may also impact the partners, suppliers and customers who do business with your company. Communicating early and clearly through direct outreach as well as through updated contracts, invoices and marketing materials may help maintain trust and build credibility during the change.



# Partnering with the right financial institution

## The Value of a Strategic Banking Professional

Throughout your business transition, the right banking partner offers more than just checking accounts or lending products — it provides strategic financial insight. A trusted banking partner may help interpret financial data, identify opportunities and align solutions with long-term goals.

PNC Business Banking offers a range of services designed to support small businesses at every stage of transition, from day-to-day banking to cash flow optimization.

## Business Checking Accounts

With [PNC small business checking accounts](#), online banking and bill pay allow you to scale your business without making more trips to the bank. Whether you only need the basics or you have more volume and variety in your transactions, we have the features and accounts to match. That includes our [Treasury Enterprise Plan](#), designed for businesses with higher cash deposit and transaction needs.

## Credit Solutions

Need financing options? Maximize working capital and reward business spending with cash back on [PNC business credit cards](#). No matter what you're looking for in a business credit card, we've got you covered. You focus on scaling your operations, we provide reliable credit options to match your business stage.

## Merchant Services

As your business expands, help keep operations running smoothly with flexible payment options that meet customers wherever they are. [PNC Merchant Services](#)® provides end-to-end processing in person, online or on the go — from swipes and dips to taps, keyed entries and online payments — with funding available as soon as the next day for deposits into select PNC business checking accounts, or even sooner with Rapid Deposit.

Built to [scale across industries](#) such as retail, restaurants, healthcare, veterinary services and nonprofits, the platform offers tools to help monitor sales and inventory, reward repeat customers, and integrate with e-commerce platforms for a cohesive experience across every channel.

## Treasury Management Services

Stay on top of business growth with [PNC Treasury Management Solutions](#). Take advantage of fraud protection tools for checks and electronic payments to

help accelerate fund availability, reduce check processing costs, and eliminate check printing and mailing costs. Deploy our [Cash Flow Insight](#)® tool to monitor cash flow month over month and take proactive steps against shortfalls.

## Business Advisory Resources

“At PNC Bank, we refer to ourselves as ‘Brilliantly Boring,’” [explains Peterson-Sheptak](#). “The reason for that is simple. Our small business clients rely on us for far more than a place to keep their money. We offer a host of services and prudent advice, and we’re reliably there for clients.

“Often that entails referring clients to the resources they need. In the case of clients just starting out, it’s finding professionals in the community to help them get advice on the right structure for them.”

## [Connect with a PNC Business Banker](#)

to address your needs, or browse the latest [Small Business insights](#) to remain informed throughout your transition.



# Take the next step for your small business

Transitioning from a sole proprietorship to a more formal business structure may feel like a big step — and for many small business owners, it is.

But with the right planning, guidance and financial support, it may lead to greater liability protection, professional credibility and business growth.

PNC Business Banking offers the financial services and strategic insight to help you

navigate this next chapter with confidence. Whether you're establishing an LLC, incorporating a C- or an S-Corp, or simply planning ahead, [visit us online](#) today to take your next steps forward together.



- 1 50-State Guide to Establishing a Sole Proprietorship, Nolo, Oct. 29, 2025, <https://www.nolo.com/legal-encyclopedia/50-state-guide-establishing-sole-proprietorship.html>
- 2 50-State Guide to Forming an LLC, Nolo, Oct. 29, 2025, <https://www.nolo.com/legal-encyclopedia/form-llc-in-your-state-31019.html>
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- 4 Choose a Business Structure, U.S. Small Business Administration, March 7, 2025, <https://www.sba.gov/business-guide/launch-your-business/choose-business-structure>
- 5 Wage Compensation for S Corporation Officers, Internal Revenue Service, Aug. 2025, <https://www.irs.gov/pub/irs-news/fs-08-25.pdf>

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