A Marlowe & Voss Guide

A Plain-English Guide to Choosing Your Business Entity

Sole proprietorship, LLC, and the S corporation election, explained in concepts rather than numbers, so you can have a better conversation about which fits.

For small-business owners · Ann Arbor, Michigan

> Educational, not tax or legal advice. This guide explains business entity concepts in general terms and on purpose contains no tax rates, brackets, thresholds, or year-specific figures. Your own decision depends on facts this guide cannot know. Talk with a CPA and, where needed, an attorney before choosing or changing your entity.

Start with the question behind the question

Choosing an entity is really choosing how your business is owned, protected, and taxed.

Owners often ask which entity is best, as if there were a single right answer. There is not. The best structure depends on how you own the business, how much personal liability protection you want, how you pay yourself, and how you want profits to be taxed. Those are different questions, and an entity is simply the package that answers them together.

This guide walks through the common options for a small business in plain English: the sole proprietorship, the LLC, and the S corporation election. It stays at the level of concepts on purpose. You will not find tax rates, brackets, or thresholds here, because those change and because the right choice for you depends on facts a guide cannot see. What you will find is a clear mental model, so the conversation with your accountant is a good one.

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Two ideas people mix up: legal form and tax treatment

The single most useful thing to understand before comparing entities is that legal form and tax treatment are two different layers.

Legal form

This is what your business is in the eyes of the state: a sole proprietor, a limited liability company, a corporation. It governs things like whether the business is legally separate from you, how ownership is documented, and what paperwork the state expects you to keep up.

Tax treatment

This is how the income is taxed by the federal government. The important and often surprising point is that one legal form can be taxed in more than one way. An LLC, for example, is a legal structure, not a tax category. By default a single-owner LLC is taxed like a sole proprietorship and a multi-owner LLC like a partnership, but an LLC can also elect to be taxed as an S corporation while staying an LLC in every other respect.

Hold on to that distinction as you read. When someone says they want to become an S corp, they usually mean they want the S corporation tax treatment, not necessarily a change in their legal form. Keeping the two layers separate in your mind is what makes the rest of this simple.

Layer	What it decides	Who cares about it
Legal form	Separateness, liability protection, ownership records, state filings.	The state, your bank, your attorney.
Tax treatment	How profit is reported and taxed, and how you pay yourself.	The federal tax system, your CPA.

The sole proprietorship

A sole proprietorship is the default when one person starts doing business and does not form anything else. There is no separate legal entity: you and the business are the same in the eyes of the law and the tax system. If you have ever done freelance or side work without setting up a company, you have run a sole proprietorship.

How it works

You report the business income and expenses as part of your own personal tax return. The profit is yours directly, and it is subject to income tax and to self-employment tax, which covers Social Security and Medicare for people who work for themselves.

What owners like about it

- It is simple. There is little to set up and little ongoing paperwork.
- It is inexpensive to start and maintain.
- Taxes flow onto your personal return without a separate business filing in most cases.

What to weigh

- There is no liability shield. Because the business is not separate, your personal assets are generally exposed to the debts and claims of the business.
- All of the profit is generally subject to self-employment tax, which is a point many owners revisit as they grow.
- It can look less established to some banks, partners, or clients than a formal entity.

The limited liability company (LLC)

An LLC is a legal structure created under state law that puts a wall between the business and its owners. That wall, called limited liability, is the main reason owners form one: if the business runs into debts or claims, the owners' personal assets are generally protected, as long as the company is run as a genuinely separate entity.

How it is taxed

Here is where the earlier distinction pays off. Forming an LLC does not, by itself, change how you are taxed. By default the tax system looks straight through the LLC: a single-owner LLC is taxed like a sole proprietorship, and a multi-owner LLC is taxed like a partnership. The profit passes through to the owners and is taxed on their personal returns. This is why people call it a pass-through.

What makes the LLC flexible is that it can also elect to be taxed as an S corporation while remaining an LLC legally. So an LLC can give you the liability protection of a formal entity with the simple pass-through taxation of a sole proprietor, and later change only its tax treatment without changing its legal form.

What owners like about it

- Limited liability protection for the owners' personal assets.
- Flexibility: it can be taxed in the default pass-through way or elect S corporation treatment later.
- A more formal, credible structure for banking, contracts, and partners, without the full weight of a corporation.

What to weigh

- There is real setup and upkeep: state formation, a registered agent, and ongoing state requirements that vary by location.
- The protection holds only if you respect the separation: a dedicated business bank account, clean records, and no mixing of personal and business money.
- By default, profits are still generally subject to self-employment tax, the same as a sole proprietorship, unless you elect a different tax treatment.

> A common point of confusion worth repeating: an LLC is a legal form, not a tax bracket. Forming one protects you legally but does not automatically change your taxes. The tax change, if it makes sense, comes from a separate election.

The S corporation election

An S corporation is not really a separate kind of company you go out and form. It is a tax election that an eligible LLC or corporation can make with the federal tax system. When people talk about becoming an S corp, they almost always mean making this election while keeping their existing legal form.

The idea in plain English

Under the default pass-through treatment, all of a business's profit generally faces self-employment tax. The S corporation election changes the picture in one important way: the owner who works in the business is expected to be paid a reasonable salary for the work they do, and that salary carries the usual employment taxes. Profit beyond that salary can then pass through to the owner in a way that is treated differently from wages. The intent is to separate the pay you earn for your labor from the return you earn as an owner.

Because this can change how much of the profit is exposed to employment taxes, the S corporation election is one of the most common reasons a growing business revisits its structure. Whether it helps depends entirely on the specifics, which is why this guide describes the concept rather than promising a result.

The reasonable salary rule

The heart of an S corporation is the requirement that a working owner pay themselves a reasonable salary before taking the rest of the profit as a distribution. Reasonable means what a similar role would be paid for similar work. This is not a place to be aggressive: setting the salary too low to avoid employment taxes is exactly what the rule exists to prevent, and it is an area that draws scrutiny. Getting it right is a judgment call best made with a CPA.

What owners like about it

- The potential to change how much profit is subject to employment taxes, once the business is consistently profitable enough for the distinction to matter.
- A structure that still passes income through to the owner's personal return, avoiding a separate layer of corporate tax.
- You can usually keep your existing LLC and change only the tax treatment.

What to weigh

- It adds real administrative work: running payroll for yourself, filing a separate business tax return, and keeping cleaner records.
- There are eligibility rules about who and what can own the business, and the reasonable salary requirement is not optional.
- It usually makes sense only once profit is high enough and steady enough that the savings outweigh the added cost and complexity. Below that point it can cost more than it returns.

A brief word on the C corporation

There is a fourth structure you will hear about: the C corporation. It is the default form for large companies and for businesses that plan to raise money from outside investors. It is a fully separate taxpayer, which is the key difference from everything above.

Because it is its own taxpayer, a C corporation is taxed on its profit directly, and profit distributed to owners can be taxed again at the owner level. That two-layer pattern is why most small, owner-run businesses do not start here. There are situations where a C corporation makes sense, often tied to outside investment or specific long-term plans, but for the typical small business the real decision is usually among the sole proprietorship, the LLC, and the S corporation election. We mention the C corporation so you know what it is and why it is usually not the small-business default.

> This guide focuses on the choices most small businesses actually weigh. If outside investors or a public-company path are part of your plans, the C corporation enters the conversation, and that is a discussion to have directly with a CPA and an attorney.

Comparing them, at the level of concepts

The table below compares the options on the questions that actually drive the decision. It deliberately avoids any numbers, because the numbers are exactly what depends on your situation and the year.

Question	Sole proprietorship	LLC (default)	LLC with S corp election
Legal separateness	None. You and the business are the same.	Separate legal entity.	Separate legal entity.
Personal liability shield	No.	Yes, if run properly.	Yes, if run properly.
How profit is taxed	Pass-through to your personal return.	Pass-through to owners' returns.	Pass-through, with a required owner salary.
Owner pay	You simply take the profit.	You simply take the profit.	Reasonable salary first, then distributions.
Setup and upkeep	Least.	Moderate.	Most.
Often revisited when	You want liability protection.	Profit grows and self-employment tax stings.	Profit is consistently high enough to justify it.

Read across a row, not down a column. There is no winning column. There is only the option that best answers the questions that matter most for where your business is right now.

A few common myths

Some ideas about entities are repeated so often that they start to sound like facts. A handful worth clearing up:

An LLC saves me taxes

On its own, no. An LLC is a legal structure that provides liability protection. By default it is taxed the same as what you were before. Any tax change comes from a separate election, not from forming the LLC itself.

Everyone should be an S corp

The S corporation election can help, but only once a business is consistently profitable enough that the benefit outweighs the added payroll, filing, and record-keeping cost. Elected too early, it can cost more than it saves. It is a decision that depends on your numbers, which is exactly why this guide does not put a figure on it.

Once I choose, I am stuck

Not usually. Many businesses evolve from sole proprietor to LLC to an S corporation election over time. The structure is meant to keep pace with the business, and changing it as you grow is normal.

My liability shield is automatic

Forming an entity is only half of it. The protection holds only if you actually run the business as separate: its own bank account, clean records, and no blending of personal and business money. Treat the entity casually and a court can too.

What changing your structure actually involves

If a change makes sense, it is worth knowing that it is a process, not a switch you flip. The specifics depend on where you start and where you are going, but in general terms it can involve:

- Forming the new entity with the state, if you are moving from a sole proprietorship to an LLC.
- Filing the right election with the federal tax system by its deadline, if you are electing S corporation treatment.
- Setting up payroll for yourself, if the new treatment requires a reasonable owner salary.
- Opening or retitling bank accounts and updating contracts, licenses, and registrations into the entity's name.
- Adjusting how you keep your books to match the new structure, so the records support the treatment you have chosen.

None of this is a reason to avoid a change that genuinely fits. It is a reason to plan the change with someone who does it regularly, so the timing and the paperwork are right.

How to think about your own decision

You do not need to become a tax expert to make a good choice. You need to answer a handful of honest questions and then talk them through with someone who can apply the current rules to your numbers.

- How much personal liability am I exposed to, and would a formal entity meaningfully reduce it?
- How profitable is the business now, and how steady is that profit?
- How do I want to pay myself, and am I willing to run payroll for myself if a structure requires it?
- How much administrative complexity am I willing to take on for a potential tax benefit?
- Where do I expect the business to be in a couple of years, and would I rather choose once or change as I grow?

It is completely normal for the answer to change over time. Many owners begin as a sole proprietor, form an LLC when liability or credibility starts to matter, and consider an S corporation election only once profit is consistently high enough for it to pay off. Changing structure as the business grows is not a mistake. It is the structure keeping pace with the business.

A conceptual walk-through

To show how the questions fit together, here is one common path, described without any numbers on purpose. It is a pattern, not a recommendation, and any real decision depends on your own facts.

Just starting out

An owner begins doing the work on their own, with modest and uncertain profit. There is little to protect and little to gain from complexity, so they operate as a sole proprietor and report the business on their personal return. Simple suits the stage.

Growing, with more at stake

The business grows. There are now contracts, a lease perhaps, and real exposure if something went wrong. Liability protection starts to matter, and a more formal structure would help with banking and credibility. The owner forms an LLC. Their taxes do not necessarily change yet, because by default the LLC is still a pass-through, but now there is a shield between the business and their personal assets.

Consistently profitable

Later still, the profit is not just higher but steady and dependable. At this point the owner and their accountant look at whether an S corporation election would change how much of that profit faces employment taxes, weighed against the added cost of running payroll and filing a separate return. If the numbers favor it, they make the election while keeping the LLC. If they do not, they wait. The structure follows the business, not the other way around.

The point of the walk-through is the sequence, not the destination. Not every business ends at an S corporation, and there is no prize for getting there fastest. The right move is the one that fits where the business actually is.

Questions to bring to your accountant

You do not have to arrive with an answer. You have to arrive with good questions. These are the ones that make the conversation productive:

- Given my liability exposure, would a formal entity meaningfully protect me, and is now the right time?
- Based on my actual profit and how steady it is, would an S corporation election help, or is it too early?
- If I elected S corporation treatment, what would a reasonable salary look like for my role, and what would the added cost and paperwork be?
- What deadlines apply if I want to form an entity or make an election this year?
- How would a change affect my bookkeeping and payroll, and can you help me set that up correctly?

A note for Michigan owners

Forming and maintaining an entity happens at the state level, so the particular filings, fees, and ongoing requirements depend on Michigan's rules and can change. The concepts in this guide hold regardless, but the specific steps for registering and keeping an entity in good standing are worth confirming for the current year with a CPA and, where legal questions arise, an attorney.

A plain-English glossary

A few terms this guide uses, defined in general concepts rather than numbers:

Term	In plain English
Legal form	What your business is in the eyes of the state: sole proprietor, LLC, or corporation.

Term	In plain English
Tax treatment	How your income is taxed by the federal government. One legal form can sometimes be taxed in more than one way.
Pass-through	When business profit is taxed on the owners' personal returns rather than on the business itself.
Limited liability	A legal shield that generally keeps the business's debts and claims from reaching the owners' personal assets.
Election	A formal choice filed with the tax system, such as choosing to be taxed as an S corporation.
Distribution	Profit paid out to an owner as an owner, treated differently from wages paid for work.
Reasonable salary	The requirement that a working owner of an S corporation pay themselves fair pay for their role before taking distributions.
Self-employment tax	The tax that covers Social Security and Medicare for people who work for themselves, rather than as an employee.

> This guide is educational and general. It contains no tax rates, thresholds, or year-specific figures on purpose, because the right choice depends on current rules and your own facts. Marlowe & Voss helps Ann Arbor owners think through entity choice as part of year-round tax planning. Please treat any decision as one to make with a CPA, and where legal questions arise, an attorney.