

Pros and Cons of Professional Corporations

What's Best For Your Practice?

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One of my clients recently asked about the best way to conduct his medical practice. For a number of years he had been in solo practice but was now considering joining with another physician. He wanted to know how to organize the new practice- what were the available options and what was the “right” way to do this? Does a professional corporation offer advantages over a limited liability company or some other form of doing business?

Since many states now offer a wider range of choices for operating a medical practice the “right” choice question comes up frequently in our client meetings. This column gives us a good opportunity to discuss the pros and cons of each alternative from the standpoint of liability protection and tax efficiency.

Professional Corporations

The most popular and well known choice is certainly the professional corporation (PC) which, is permitted in every state. A PC allows a licensed professional to conduct his practice in corporate form and be treated under state and federal tax rules as a corporation. Does a corporation provide any significant tax benefits? Not much any more. Back in the 1970's when physicians first gained the right to incorporate, the benefits were substantial. In particular, the prized tax advantage of corporations was the ability to establish a corporate retirement plan-allowing large amounts to be saved tax free each year. There was no comparable plan for non incorporated individuals. IRA's had minimal contribution limits and Keogh plans (for the self-employed) were only slightly better. Corporate retirement plans were the holy grail of tax planning because they generated large immediate deductions and the funds in the plan could be borrowed back for any purpose or invested in almost any manner.

Over the years, Congress and the IRS eliminated almost all of these advantages. Although corporate retirement plans are still excellent savings vehicles, the same types of plans and most other benefits are now permitted for non-corporate practices as well. So, incorporating your practice to gain supposed tax advantages just doesn't make much sense anymore.

What about legal benefits? Are PC's useful for lawsuit protection? The basic rule is that a corporation won't insulate you from your own malpractice or from that of your

employees. PC's, unlike general business corporations, do not legally shield the owner from a negligence claim. As a result, for those in solo practice, the PC offers no legal advantage. Every individual physician is liable for his own negligence, whatever the form of his practice.

However, a PC can be important for those who practice in a group or with another physician. In this situation, the use of a PC can protect against personal liability for the negligence of a partner. That's a good reason why group practices are often structured as a single PC or as a partnership of PC's with each physician owning his own corporation. As I said, it won't shield you from your own malpractice but it should insulate you from your partner's negligence and that is certainly an important accomplishment.

Professional Limited Liability Companies

In addition to PC's there are two other entities, both relatively new, which can accomplish the same degree of liability protection in a joint practice arrangement. The Professional Limited Liability Company (PLLC) and the Limited Liability Partnership (LLP) both provide similar benefits. Although not permitted in every state, the idea behind these entities is that they are both efficient, easy to administer and free of the tax problems often associated with corporations. While corporations, (particularly C corporations) require careful attention to record keeping, accounting and tax details to avoid potentially disastrous consequences, no such problems exist with the PLLC or LLP. The income of either of these entities is simply passed through to the member or partner who reports his share on his personal tax returns.

How to Choose

Now, getting back to our original question of the "best" way to organize a practice our conclusions are:

1. Those in solo practice have no malpractice lawsuit protection or material tax benefits from practicing as a corporation, Professional Limited Liability Company or Limited Liability Partnership. These entities may avoid personal liability for company debts such as leases, loans or other obligations which are not personally guaranteed. In some situations those may be legitimate concerns.
2. In a joint practice, any of these entities may be appropriate (depending on state law) to shield you from the malpractice of a partner. A PC accomplishes this but comes with a fairly high administrative burden and a variety of tax traps for the inattentive. Using an S Corp, rather than a C Corp can avoid a number of potential tax problems and is usually the proper choice if a PC is the only option. If you practice in a state which permits the formation of PLLC's or LLP's, the liability protection and easy maintenance may make this the best legal arrangement for the practice.

Professional Corporations no longer hold a tax advantage over other forms of practice and your choice of an entity, or solo practice, should be based on your particular liability risks. For convenience, ease of administration and tax efficiency a PLLC or LLP, if available in your state, may be preferable to a traditional PC. As always, we strongly urge that you consult with your legal and tax advisors to make sure that your particular circumstances are thoroughly considered.

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