Choosing the Best Legal Structure for Your Professional Practice

There are a variety of legal structures you might choose for your practice. Understanding your options is important since these structures are often the building blocks for alternative practice models such as independent practice associations (IPAs) and management service organizations (MSOs). Given the evolving health care marketplace, it is important to know how traditional legal business models compare to alternative practice models. In some cases, considering the alternatives may lead you to conclude that you simply want or need to shore up your practice by creating a formal legal structure where none currently exists.

If you have a business plan (see apapracticecentral.org/business/management/tips/secure/business-plan.aspx), you should consider reviewing that document to see if you need to make any changes to your current practice model. If you are just getting started in practice, you will want to consider the following factors in deciding what kind of legal structure to adopt:

- The type(s) of services you offer
- The size of your practice, including whether you may plan to hire or jointly own the practice with other health care providers (and perhaps from other licensed health disciplines)
- The amount of control you want to have over the administrative operations
- How much organizational structure you would like
- Tax implications for various practice models
- Plans for the future of your practice (for example, do you plan to keep it small or seek to grow the size of your practice?)
- Your desire to limit or separate your personal liability from the practice's liabilities
- The likelihood of being involved in a lawsuit reflecting the types of services you provide or plan to provide (for example, forensic work)
- The practice's expected profits or losses
- Your need to access capital

This article discusses six types of legal structures and potential advantages and disadvantages of each model — sole proprietorship, general partnership, limited partnership, limited liability partnership, corporation and limited liability company. The accompanying chart outlines key comparative advantages and disadvantages for the models described taking into account the factors listed above.

Importantly, the requirements for different legal structures may vary by state. And not all of the models described are available in all states. For example, the limited liability partnership is a relatively new concept and therefore is not recognized universally. In addition, some states require that business owners who provide licensed services — such as health care services (psychology or medicine, for example), accounting or law – set up either a professional limited liability company (PLLC) or professional corporation (PC), as these kinds of entities are designed to provide licensed professional services.

Yet another important consideration is that your state may have a corporate practice of medicine statute that sets limitations on what other health care disciplines may be integrated in your practice. For example, your state law may not allow psychologists to set up a PC or PLLC with physicians to provide psychological and medical services.

In light of such variability, this article provides a basic general overview of alternative practice models. Practicing psychologists are urged to consult with a local attorney and financial advisor to discuss important tax implications, relevant state corporate laws and other legal/regulatory considerations in deciding how to best structure your practice.

Sole Proprietorship

This is the simplest and least expensive way of structuring your professional practice. A sole proprietorship is an
unincorporated business in which you are the sole owner with the complete authority to make all business decisions. There is no legal distinction between you and your practice.

All of the practice’s assets and profits belong to you. However, you are also personally liable for all of the practice’s debts, losses and liabilities. If you have employees, you are legally liable for their actions, too. Your personal liability is unlimited, so both your business and personal assets may be at risk. Your ability to access capital for your practice will depend on your personal credit since a sole proprietorship is not an incorporated business entity.

You do not have to take any formal action to set up a sole proprietorship. If you are the owner of your practice, your practice is automatically considered a sole proprietorship simply by being in business. But like all businesses, you may need to obtain the necessary licenses and permits. Because you and your practice are one and the same for tax and legal purposes, any practice income or loss is reported on your personal income tax return. As a sole proprietorship, your practice does not need to file its own tax return.

**Partnership**

If you are interested in co-owning the practice with other colleagues, you might consider a partnership. Under a partnership, the partners contribute money, property, labor and expertise to the business. There are three types of partnerships: general partnership, limited partnership and limited liability partnership.

Although there are many similarities, the three models differ as to level of control of the business and personal liability. It is important to consult with an attorney to draft a partnership agreement in order to address how ownership and business authority will be shared, how decisions will be made, how disputes will be handled and how to deal with a buyout if a partner wants to leave the partnership.

Depending on the type of partnership, it may also need to be registered with the state, typically through the Secretary of State. Further, the partnership would need to obtain any necessary business licenses and permits. As a partnership, the practice may have greater access to capital since it has its own assets distinct from the individual partners’ personal assets.

**General Partnership (GP):** The basic form of partnership is a general partnership where the general partners own and manage the business together. All of the partners are involved in the business decisions. Like the sole proprietorship, the tax issues are fairly simple. Although the partnership must file a tax return, it does not pay taxes on the income. Rather, the tax liability “passes through” to the individual partners who personally pay taxes on the partnership income.

General partners share equally in the profits and losses. In addition, each general partner has unlimited personal liability under the partnership for its debts, losses and liabilities. This also includes personal liability for the unlawful or inappropriate actions (or omissions) of another general partner and any employee(s). Unlimited personal liability often makes this particular type of partnership less attractive than the other options.

**Limited Partnership (LP):** A limited partnership is a more complex structure that includes general partners and limited partners. The general partners operate the partnership so they are responsible for the decision making, whereas limited partners have no active role in daily operations and serve as investors in the partnership. While general partners are personally liable under the partnership, limited partners have limited personal liability for the partnership’s liabilities. Limited partners’ liability is limited to their original investment in the partnership.

Like general partnerships, the partnership’s tax liability passes through to the individual partners to report their respective shares of the income or losses on their personal income tax returns.

**Limited Liability Partnership (LLP):** Unlike general partnerships, partners in an LLP enjoy limited personal liability. LLP partners are not liable for acts, omissions or negligence by another partner. However, they are still personally liable for their own malpractice or incompetence or that of any employee whom they directly supervise. Unlike a limited partnership, however, all of the partners in an LLP generally can actively manage the business.

The requirements for setting up an LLP may vary from one state to another. Even more fundamentally, in some states, the LLP is available only to certain professions – for example, accountants, lawyers, doctors and dentists.

**Corporations**

This is usually the most complicated and expensive business structure to set up. A corporation is chartered by the state and considered to be a separate legal entity from the owners (shareholders). In most cases, liability for the practice’s debts is limited to the corporation’s assets. That means a shareholder is liable only to the extent of his or her investment in the corporation.

Decision making is based on stock ownership of the
shareholders. But generally, the corporation’s management is centralized in a board of directors or elected officers. Only the corporate officers, authorized by the board of directors, may act on behalf of the corporation and commit corporate assets. The corporation continues to exist even if a shareholder sells or transfers his or her corporate stock shares.

Additional requirements exist with regard to the establishment and operation of a corporate board of directors, documentation and recordkeeping. Any practitioner considering this option is well advised to consult an attorney to prepare the articles of incorporation and other required filings. Like partnerships, the corporation would need to be registered with the state.

As a corporation, your practice would pay its own income taxes and file its own tax return. In addition, the shareholders may pay income tax on distributed profits that they receive as dividends. This means that corporate income is subject to “double taxation.”

For federal income tax purposes, you may elect to have the corporation treated as an “S Corporation” (under federal tax laws) to avoid “double taxation.” In most cases, S Corporations do not pay taxes on income and losses. Instead, the tax liability passes through to the individual shareholders on their personal income taxes – similar to partnerships. There are other specified criteria that a corporation must meet to qualify as an S Corporation.

In many states, health care practices are considered “professional corporations” (as compared to ordinary business corporations) because the services provided by the practice require a license. The laws governing how PCs are set up, owned, managed and operated vary by state. Some states require that all of a PC’s shareholders have the same professional license. Other states also require that the officers and directors be licensed in the same profession; in other words, these states do not allow multidisciplinary practices. Unless otherwise specified in your state law, it is likely that all members of your professional corporation must be psychologists. Currently, fewer than half of states in the U.S. allow for some degree of integration among psychologists and physicians.

### Limited Liability Company (LLC)

A limited liability company is a hybrid of a corporation and a partnership. The LLC is one of the most flexible options and probably the most popular because of the combined

<table>
<thead>
<tr>
<th>TYPE OF LEGAL STRUCTURE</th>
<th>Who controls the operations?</th>
<th>Simple to set up &amp; operate?</th>
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<tbody>
<tr>
<td>SOLE PROPRIETORSHIP</td>
<td>Psychologist (sole proprietor) exercises complete control</td>
<td>Yes</td>
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<tr>
<td>GENERAL PARTNERSHIP</td>
<td>Shared decision-making among partners</td>
<td>Relatively easy; minimal set-up costs</td>
</tr>
<tr>
<td>LIMITED PARTNERSHIP</td>
<td>Active management limited to general partners; lack of active control for limited partners</td>
<td>Relatively easy; minimal set-up costs</td>
</tr>
<tr>
<td>LIMITED LIABILITY PARTNERSHIP</td>
<td>Shared decision-making among partners</td>
<td>May only be available to certain professions in some states; may be more difficult to set up</td>
</tr>
<tr>
<td>(PROFESSIONAL) CORPORATION</td>
<td>Management centralized in board of directors or elected officers; decision-making based on stock ownership</td>
<td>Generally, most complicated and expensive structure to set up; state law may limit integration with other types of licensed health care providers</td>
</tr>
<tr>
<td>(PROFESSIONAL) LIMITED LIABILITY COMPANY</td>
<td>Members may be involved in the decision-making or may hire someone to run the company</td>
<td>More complicated than sole proprietorship or partnership but most popular option because of combined tax and liability advantages</td>
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liability and tax advantages. This structure offers limited personal liability for members (similar to a corporation’s shareholders or a partnership’s partners). LLCs are not recognized by the federal government for tax purposes, so they are taxed either as a corporation, partnership or sole proprietorship. Generally, the LLC’s income would be reported on the members’ personal income tax returns. Even so, it is important to consult with an accountant to determine how an LLC may elect to be taxed.

Although some states require there to be at least two members of an LLC, other states are starting to allow single-member LLCs. Members of an LLC can include individuals, corporations and/or partnerships. Members of the LLC can be involved in the decision making regardless of the size of their financial investment in the company. Alternatively, the LLC could hire someone to run the company.

As with a partnership, you should have an attorney draw up the LLC’s articles of organization and a formal operating agreement for members describing how the company will be run, how profits will be shared and whether the LLC would continue to operate if a member chooses to leave the business. In general, forming an LLC is more complicated than forming a partnership but avoids some of the complex and often burdensome corporate formalities. Like partnerships or corporations, the LLC would need to be registered with the state.

Also similar to corporations, states may have provisions requiring licensed professionals seeking to set up an LLC to designate their company as a professional limited liability company (PLLC). This particular kind of LLC is required for the business owner who must be licensed in order to practice his or her profession – for example, psychology, medicine and law. But, as with professional corporations, certain states may not allow PLLCs to be established as multidisciplinary health care practices. There may be similar state law restrictions on integrating different disciplines into a single practice so it is important to check the laws in your state.

Your ultimate decision about an organizational model for your practice will have many legal and financial implications. Therefore, you should consult with your attorney and accountant/financial advisor in making the best choice for you.

NOTE: The information presented in this article is for informational purposes only and does not constitute legal or financial advice.