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Protect your assets by incorporating your practice

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Physicians are innovative thinkers, but their formal education does not reveal the nuances between different corporate structures. These options, including limited liability corporations (LLCs), S corporations, and C corporations, provide physicians with a range of options when considering how to incorporate a medical practice.

The key is to consider what will work best for your practice now as well as laying the groundwork for future endeavors—and potentially save you hundreds of thousands of dollars over time.

Just as infection is prevented by sterilizing instruments, asset breaches are avoided by “wrapping” them in the gauze of impermeable trusts and proper estate planning. Physicians and their practices often have substantial assets at risk, and proper protection needs to be established early on. One key point, no matter what asset structure is used, is to know the importance of separate entities. If your practice, home, automobiles, summer home, rental properties, and other assets are part of the same company or trust, you hold liability for the sum total of all of these assets—thus any legal conflict (malpractice, divorce, battle with business partners, etc.) could make everything within the single structure vulnerable. We strongly advise against that.

So what structures are recommended to set up your medical practice, protect assets, and establish any new business endeavors?

An LLC is often favored by physicians, with good reason. An LLC offers tax benefits and can save a physician major headaches. However, it needs to be set up properly. There is no better method of keeping wealth untouched by creditors than by ensuring it remains untouchable. This is the essence of asset protection.

The consequences of incorporating improperly

Let's take a look at the predicament of the fictitious “Dr. Stevens,” who learned the hard way. He owned multiple assets including a speedboat, vacation home, an apartment building, a brokerage account, and a plot of undeveloped land.

LLC Points to Consider

- ✓ LLCs offer “best of both worlds” between partnerships and corporations because they don’t require formalities, maintenance, and rules of corporations.
 - ✓ An LLC’s taxation, like a partnership, is pass-through resulting in only one layer of tax.
 - ✓ A partnership requires at least two parties, but, LLCs can be formed with one member.
 - ✓ The LLC is a pass-through entity, so if you earn \$100,000, the LLC makes nothing. The income passes through to the owner.
 - ✓ The LLC is not a taxable entity. (This isn’t a loophole!)
 - ✓ LLCs offer different share classes.
- Typically different share classes will have different rights and responsibilities regarding ownership, voting, and other decision making.
- ✓ LLCs have limited life, so when a member leaves an LLC, the business is usually dissolved. This means members must fulfill all remaining legal and business obligations to close the business. The members who remain may start a new LLC. A possible work around is to add provisions in the operating agreement prolonging the life of the LLC should a member opt to leave the business.
 - ✓ An LLC’s members are self-employed and must pay self-employment tax contributions towards Medicare and Social Security. The entire net income of the LLC is subject to this tax.

One day, Stevens’ son and two of his friends went on a joyride in the speedboat. His son hit a dock at full speed, crippling his two friends. Alcohol was involved and Stevens was hit with a multi-million dollar lawsuit, far in excess of the speedboat’s policy limits.

At this point, you might expect to hear that Stevens’ remaining assets were all held in his own name. If this were the case, Stevens would be in dire straits since the plaintiffs would almost certainly win at trial, attach a lien on Stevens’ remaining assets, and seize or foreclose in satisfaction of the judgment. Worse yet, if the vacation home were to be foreclosed upon, it would be treated as a taxable sale: if the jury returned with a \$2 million verdict and Dr. Stevens had bought the home for \$1 million, he would not only lose his equity, but also be slapped with a tax bill on his \$1 million gain.

Dr. Stevens believed he was adequately protected. Years earlier he was advised by a patent lawyer to put his brokerage account, vacation home, and land in a corporation. Doing so, it was explained to him, would insulate him from liability due to the limited liability benefits of a corporation.

This was poor advice. While it is true that a corporation provides a level of protection from liability, this typically only applies to negligent actions of the corporation itself. And since the

damage was the result of the speedboat accident (which was not owned by the corporation), there was nothing to stop the plaintiffs from simply seizing the stock and then dissolving the company. In addition, his corporation was subject to taxation at both the corporate and shareholder level, meaning his brokerage account gains were taxed twice.

Worse, there were a bevy of corporate formalities required that Stevens failed to keep up.

Next, we'll show you how to avoid Stevens' pitfalls.

The Solution: Multiple LLCs

Stevens would have been better served by placing his assets, including the speedboat, in separate LLCs—which are ideal vehicles for asset protection since they protect from both inside and outside liability.

If Stevens' brokerage account and land were in separate LLCs, the plaintiffs would have a difficult time directly seizing them.

S & C corporations

S-corporations have only one share class. **C corporations** have several share classes.

S corporations might be subject to special taxes if the corporation has retained earnings from any previous tax year in which the company was taxed as a **C corporation**. (This may be unusual for a medical practice, but it is not impossible.)

C corporations allow assets to stay within the company, yet are taxed on all income generated at the corporate level, even if the income is paid out in the form of dividends.

One major disadvantage of the **C-corporation** is taxation at two levels: the corporate level and the individual (employee) level. A large corporation, such as IBM, is taxed at 36% and the company can do what it wants with the profits (or what management and the board of directors wants). However, 64% will stay within the company, a taxable entity.

This example illustrates outside liability. That is, liability not related to the property. Since there is nothing for the litigants to go after, the rest of his assets are protected. In such a case, the litigants would most likely accept the insurance company's policy limit.

Inside liability involves liability stemming from the property itself. For example, suppose a tenant slipped on the sidewalk of Stevens' rental property. If this property was in an LLC, he would be safe from claims stemming from the injury since Stevens' outside assets are shielded from negligent actions associated with the business.

At the heart of the LLC, asset protection is the ability to increase one's bargaining power. Since Stevens' assets outside of the LLC were protected, his pockets are suddenly much shallower, making him a far less tantalizing target for personal injury attorneys. He is now in a better position to settle the case for a fraction of what he is being sued.

As discussed earlier, if the medical practice owns the building and/or expensive equipment, (referred to legally as Property, plant, and equipment, or PP&E) and it were to depreciate, this would allow for a tax deduction (sheltered income).

Other incorporation options

Yet there are times where physicians choose to structure their medical practices in an S Corporation, also called a sub-S, or, in some cases, a C corporation.

For the most part, S corporations are free from federal income tax. However, they must pay taxes on certain capital gains and passive income, according to the internal revenue service (IRS). They have a pass-through structure, meaning that net losses—or profits—are passed through to shareholders. The IRS explains it as follows: "On their tax returns, the S corporation's shareholders include their share of the corporation's separately stated items of income, deduction, loss, and credit, and their share of nonseparately stated income or loss."

A great advantage of the pass-through configuration of an S corporation is that its profits are only taxed once—at the shareholder level, so they are able to avoid dividend double taxation.

These structures can also keep net profits as operating capital.

It's important to note, however, that all profits are considered as if they were distributed to shareholders. So an S Corporation shareholder might be taxed on income never received. If you're the only owner—perhaps a physician establishing a solo practice with few employees—then an S-corporation is likely to be a good business structure for the practice itself. There is also only one share class, so everyone holding shares will have the same shareholder rights. This may be an advantage as a practice grows—for example, a more junior physician could develop equity in a growing practice and be incentivized through a greater investment in the business.

On the other hand, a founding partner, who will have A-shares, may want junior partners to have B-shares. This would be beneficial in a large practice that might want younger physicians to have equity, however, retain less voting control. This distinction in share classes also allows for different “calls” on the income of the business: A-shares participate in profit-sharing first, while B-shares participate later. Of course, specific financial structuring needs to be clearly expressed within the corporate documents.

Series LLCs

As described in the Stevens example, it is generally advisable to set up multiple LLCs for protection. Certain states (Texas and Illinois are two) allow the use of the Series LLC, which is structured with a “father” LLC and several “children” LLCs.

Each “child” LLC has its own books and members. Series LLCs separate assets into their own entities, minimize liability, and reduce paperwork and formation costs. Rules vary for LLCs state by state, so you'll want to be clear about the laws in yours.

Separate LLCs, or in some cases parent/child LLCs, should be created to own the land and/or the equipment, as more asset protection may be available if the practice is structured as an LLC rather than an S corporation.

Limited Liability Partnerships

Another potential corporate structure option is a limited liability partnership, or LLP. This only requires a partnership agreement, whereas an LLC requires an operating agreement. Often an LLC is employed because it solves some of the problems inherent in both corporate and partnership structures.

Remember, each “new” business or property may require a new LLC wrapper to protect that business; you don't want someone to fall on your property and have all of your assets drawn into litigation.

All corporate structures have distinct advantages and disadvantages over time. Depending on where you practice medicine, we recommend consulting a professional who knows not only how the law applies in the state where you practice medicine, but understands how best to structure your overall wealth enterprise.



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