

**Brown McCarroll L.L.P.**

**Business Entity Structures for the Speech-Language Pathologist in Private Practice**

Texas Speech-Language-Hearing Association  
2008 Annual Convention  
Saturday, February 23, 2008 1:30-2:30 p.m.

Presented by: Albert Lin, Partner  
Brown McCarroll L.L.P.  
Austin, Texas

Austin Dallas Houston Longview El Paso

**Presentation Outline**

- I. Starting Your Own Practice
- II. Legal Considerations/Choice of Entity
- III. Federal and State Tax Considerations
- IV. Business Plan Outline
- V. Conclusion/Question & Answers

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**I. Starting Your Own Practice**

- Why?
  - Pathologists/Audiologists may separate from affiliations with physician practices.
  - Physicians able to concentrate on medical services while divesting themselves from issues relating to speech pathology/audiology.
  - Chance to "hang out on own shingle" attractive.
  - Opportunity to offer products/services above and beyond mass-market (i.e. Costco).

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**I. Starting Your Own Practice**

- Why not?
  - Requires legal, business, accounting knowledge in addition to professional knowledge.
  - Fairly high capital investment required; constant changing technology.
  - Pathologists/audiologists benefit from close relationship with physicians.

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**II. Legal Considerations – Choice of Entity**

- All right – I'm going to do it!
- First, work on a detailed business plan.
  - Determine business inflows/outflows
  - Determine capital investment required (equipment, office space, furniture, etc.).
  - Determine number of business partners/employees.
  - Determine liabilities required (loans, leases).

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**II. Legal Considerations – Choice of Entity**

- Second, determine a legal form of the new business.
  - Can be either "for-profit" or "non-profit." Speech pathologist/audiologist practices have been established as both for-profit and non-profit.
    - For-profit – traditional form of business, no limitations on distribution of profit/dividends.
    - Non-profit – formed if professionals intend to rely on public grants/governmental funding/charitable donations.
  - Avoid commercial "corporate outfits" since they usually fail to inform business owners of all consequences of a particular form of business entity.

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## II. Legal Considerations – Choice of Entity

### • For-Profit – Choice of Entity – Legal Considerations.

- "Choice of Entity" refers to the selection of legal and tax forms of a business entity.
- Choices for most speech pathologists/audiologists in private practice include:
  - **Sole proprietorship** – no liability protection – creditors can seek recovery from personal assets of sole owner of business.
    - Sole proprietorships are administratively the simplest organizational form.
    - Requires only the filing of a "DBA" (doing business as) or "Assumed Name Certificate" – document filed with the county clerk's office to let the public know that you have a business.
  - **General partnership** – no liability protection – creditors can seek recovery from personal assets of all partners, jointly and severally.
    - Similarly, administratively the simplest entity for businesses with more than one owner.
    - Also requires a "DBA" or "Assumed Name Certificate."
    - Written partnership agreement highly recommended.

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## II. Legal Considerations – Choice of Entity

### • For-Profit – Choice of Entity – Legal Considerations.

- **Limited liability company/professional limited liability company** (LLC or PLLC) – creditors of the entity limited to assets of LLC.
  - Administratively, this is the simplest form of entity with limited liability protection.
  - The terminology takes getting used to – owners of LLCs are called "members" and the governing board members are called, collectively, "managers."
  - A written governing agreement, called "company agreement" highly recommended.
- **Corporation/professional corporation** – as with LLCs/PLLCs, creditors limited to assets of corporation or professional corporation.
  - Lobster trap analogy – easy to enter, difficult to escape.
  - Most traditional form of organization, but administratively more rigid than other forms
  - Severe tax disadvantages.
- **Caveat** – in both forms above, need to "respect the corporate form" by keeping proper books & records and avoiding commingling of personal and corporate assets; otherwise liability protection is lost.
- Other forms exist but should probably not be used for speech pathologists/audiologist practices (*limited partnerships, limited liability partnerships*) due to administrative expenses involved.

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## II. Legal Considerations – Choice of Entity

### • Non-Profit – Choice of Entity – Legal Considerations.

- "Non-profit" form of organization less frequently used, but still relevant for speech & hearing pathologist as they may work with nonprofit organizations.
- Two key characteristics of nonprofit corporations – offers **liability protection** to principals, **but can never, ever, distribute net earnings** (i.e. net profit after expenses (including reasonable compensation)).
  - Nonprofits can only pay parties *reasonable* compensation for services rendered.
  - Upon liquidation, assets owned by nonprofits must be turned over to other nonprofits or applied towards charitable purposes.
  - Far more difficult to understand from a corporate and tax standpoint.
- *Consider a nonprofit only if legal limitations (particularly compensation limitations) acceptable to founders.*

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## III. Federal and State Tax Considerations – Choice of Entity

### • For-Profit – Choice of Entity – Tax Considerations.

- **Sole Proprietorship.**
  - No separate tax return required (business activities reported on Schedule C of Form 1040).
  - Net income from sole proprietorship subject to 15.3% self-employment tax in addition to ordinary income tax (ranging from 0% to 35%).
  - No 1% Texas margin tax assessed on taxable revenue base.

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## III. Federal and State Tax Considerations – Choice of Entity

### • For-Profit – Choice of Entity – Tax Considerations.

- **General Partnership.**
  - Requires preparation of Form 1065 (U.S. Return of Partnership Income).
  - No entity-level tax on income of a partnership – instead, partners report their percentage share of income on Schedule E of their Form 1040.
  - Net income is subject to 15.3% self-employment tax.
  - No 1% Texas margin tax so long as only natural persons are partners.

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## III. Federal and State Tax Considerations – Choice of Entity

### • For-Profit – Choice of Entity – Tax Considerations.

- **Limited liability company/professional limited liability company.**
  - Requires preparation of Form 1065 (U.S. Return of Partnership Income); UNLESS there is only one owner (member)
  - Like a general partnership, net income of the LLC/PLLC is not subject to federal income tax. Instead, each LLC/PLLC member reports his/her percentage share of net income on the individual Form 1040.
  - Net income is subject to 15.3% self-employment tax if members actively participate in management.
  - Revenues are potentially subject to the 1% Texas margin tax (generally an issue only if the entity earns more than \$300,000 in gross revenue annually).

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### III. Federal and State Tax Considerations – Choice of Entity

- **For-Profit – Choice of Entity – Tax Considerations.**
  - *Corporation/professional corporation.*
    - Corporation/professional corporation may choose to be treated by the IRS either as a “C” corporation or as an “S” corporation.
      - Refers to subchapter C or S of the Internal Revenue Code.
      - Upon formation of a state corporation, the default classification is a “C” corporation.
      - The “S” corporation classification is chosen by filing a one-page form with the IRS within 75 days of formation (Form 2553).

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### III. Federal and State Tax Considerations – Choice of Entity

- **For-Profit – Choice of Entity – Tax Considerations.**
  - *“C” corporation.*
    - Most publicly-traded companies and companies with many shareholders (i.e. 50+) tend to be “C” corporations.
    - Primary disadvantage of “C” corporation – the net income of a “C” corporation is subject to *double taxation*.
      - First, the net income is subject to a 15% to 35% income tax assessed on the “C” corporation’s federal income tax return.
      - Second, after payment of corporate taxes, the net income is paid to the shareholders as dividends, where it is subject to tax at dividend tax rates (generally, 15%).
      - Thus, total tax hit on regular corporations can potentially be 45% of net income when both corporate and individual taxes are considered.

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### III. Federal and State Tax Considerations – Choice of Entity

- **For-Profit – Choice of Entity – Tax Considerations.**
  - *“C” corporation continued.*
    - “C” corporations also may be subject to a flat 35% corporate tax rate if the corporation is a “personal service corporation,” which generally includes all “C” corporations in which the primary activity is provision of health-related services.
    - “C” corporations do have some tax benefit in that wages may be paid to all shareholders via W-2 (avoiding self-employment taxes).

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### III. Federal and State Tax Considerations – Choice of Entity

- **For-Profit – Choice of Entity – Tax Considerations.**
  - *“S” corporation.*
    - Very common for small physician practices which are formed as professional associations.
    - Offers certain advantages of “C” corporations, but is NOT subject to the double-tax problem.
      - Each “S” corporation shareholder reports a percentage of the “S” corporation’s income on his/her tax return.
      - Similar to LLC/PLLC in that both “S” corporations and LLC/PLLCs are “pass-through” entities for tax purposes.
      - Primary advantage over LLC/PLLCs – potential to save on employment taxes to shareholders if revenues are high enough.

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### III. Federal and State Tax Considerations – Choice of Entity

- **For-Profit – Choice of Entity – Tax Considerations.**
  - *“S” corporation continued.*
    - IRS limitations on who can own “S” corporations can be an issue.
      - Cannot have non-natural persons as shareholders (only a few exceptions such as certain trusts and 501(c)(3) tax-exempt organizations).
      - Causes problems if a corporation or other legal entity wishes to acquire the “S” corporation.
    - The requirement of pro-rata income distributions can be a problem.

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### IV. Business Plan Outline

- Basic components of a business plan (necessary exercise prior to starting your own practice).
  - Executive Summary (short, one paragraph description)
  - Company Analysis (legal structure, ownership & capital)
  - Industry Analysis (overview of prospects, impact of technology)
  - Description of Customers & Competition (local, statewide, etc.)
  - Marketing Plan (how will you obtain customers)
  - Operational Plan (how will the business be carried out, employees, administrative assistance, etc.)
  - Management Team (who will lead)
  - Financial Plan (pro forma financial statements)

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## V. Conclusions

- Speech/hearing pathologists preparing to go into private practice will likely form either (1) an LLC/PLLC, or (2) corporation/professional corporation (taxed as an "S" corporation). Decision to be an S corporation will hinge primarily on self-employment tax savings.
- Prepare business plan to identify all issues prior to starting the new business.
- Legal and accounting advice critical early in process.
  - Legal considerations – corporate, employment, contracts, leases, coordination with physicians, licensing.
  - Accounting/tax – federal income, state/local property, state franchise tax, federal/state employment, state/local sales tax.

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## V. Question & Answers

Please contact Albert Lin

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for follow-up questions.

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