

CORPORATE MATTERS: PROFESSIONAL LIMITED LIABILITY COMPANIES AND PROFESSIONAL CORPORATIONS

Author
Simon Prisk

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In our March issue we discussed incorporation basics and entity selection. We focused on limited liability companies and corporations, as they are the most common entities used. We thought it might be helpful to follow up on that article with a brief discussion on professional limited liability companies and professional corporations.

PROFESSIONAL LIABILITY COMPANY

A professional limited liability company (“P.L.L.C.”) is organized for the sole purpose of providing professional services by licensed professionals. Generally, states don’t allow L.L.C.’s for businesses where a license is required. Licensed professionals who want the benefits of an L.L.C. must form a P.L.L.C. instead. A P.L.L.C. must be organized solely for the purpose of engaging in either a single licensed profession, or in two or more that can be lawfully practiced together. The name of the business must include the words “professional limited liability company,” or the abbreviation “P.L.L.C.” Generally, any person who is licensed to practice in a state under a designated profession may organize a P.L.L.C. A professional is a person licensed in a field such as health, law, engineering, architecture, accounting, actuarial science, or another similar field. However, licensing requirements may vary state by state. Therefore, one must thoroughly review the applicable statute for the state in which the P.L.L.C. will conduct business.

A professional or group of professionals considering incorporation would consider a P.L.L.C. for the favorable pass-through tax treatment and limited liability – a member of a P.L.L.C. is not liable for acts of another member or the entity’s debts. Note, however, that members remain personally liable for their own professional misconduct or malpractice. So, even if you practice a profession through a P.L.L.C., it is a good idea to carry malpractice insurance.

PROFESSIONAL CORPORATION

A professional corporation is a corporation organized by individuals who offer professional services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts and consulting.¹⁶

The shareholders in a professional corporation must be licensed professionals who are employed by the corporation. The abbreviation "P.C." must appear after the name of the corporation and the professional corporation must state explicitly in its articles of incorporation that its sole business purpose is to render professional services. A professional service is one that is rendered by a person who is considered a professional and has been issued a license to perform that service.

A professional corporation is taxed like a C-corporation by default and, therefore, is subject to a corporate level of income tax. In addition, shareholders may be subject to a second tax when earnings and profits of the corporation are distributed as dividends. A tax advantage of practicing in a professional corporation is the ability of the corporation to provide certain fringe benefits tax-free to its employees or shareholders. Some of the tax-free benefits include accident, health and life insurance.¹⁷ In addition, the professional corporation may deduct for ordinary and necessary business expenses that occurred during the tax year.¹⁸ The professional corporation can use these advantages to minimize double taxation by paying shareholders a salary or fringe benefits instead of accumulating profits and then distributing dividends, effectively reducing its net income to potentially insignificant amounts. Alternatively, professional corporations may have the option of electing to become an S-corporation, an entity subject to certain limitations but with pass-through benefits, applicable in the same way as they would be for a P.L.L.C., eliminating the double taxation issue entirely. Shares in a professional corporation can only be transferred to a person who is a licensed professional, and a professional corporation must be dissolved when there are no longer any shareholders who are licensed professionals.

The decision whether to form a P.L.L.C. or a P.C. involves the same considerations as choosing between an L.L.C. and a C-corporation. Do you want a pass-through entity or one that is subject to tax at the entity level?

¹⁶ Code §448(d)(2).

¹⁷ Code §§79, 105, 106, 132(f).

¹⁸ Code §162(a).