THE PATIENT-CENTERED & DATA-DRIVEN ISSUE
Should Your Practice be a Corporation, LLC or . . . ?

Having the right entity is important — financially and legally

Whether you are just starting your audiology practice or have been in business for a while, the type of entity you are operating under can have a profound impact on you both financially and legally. A good fit for one practice may not be a good fit for another as no two businesses are alike. Asking yourself the following questions can help you begin the entity selection process:

- How large do I expect the business to become?
- Who will be the owners in my business?
- What are my financial goals over the next 3, 5 and 15 years?
- How much is it going to cost to organize and maintain the entity?

Answering the above questions is only the beginning of the entity selection process. Seeking out sound advice from an expert ensures the best entity selection. This advice can come from an attorney and/or a certified public account (CPA). Often, seeking guidance from both will lead to better results. This article will educate you on the various entity choices, what to expect after choosing your entity, and how to achieve the best financial results for your business.

BY JEREMY KIECKER, CPA
What are my entity choices?

You have various entity options. Each comes with its own advantages and disadvantages. Table 1 summarizes the most common entity choices, along with their respective characteristics.

Having the wrong entity in place can choke off profits and impact cash flows. For example, business owners often have difficulty budgeting for tax liabilities that may be owed throughout the year (estimated tax payments), and at year-end. Not making estimated tax payments throughout the year can create a cash crunch at year-end or when filing the required tax returns. Utilizing an S Corporation may alleviate this burden, as it requires a salary and withholding of taxes. This lessens the estimated tax payments and/or balances that might be due when filing the annual tax returns.

Operating an entity such as a proprietorship, LLC or LLP that requires payment of self-employment taxes and, in turn, higher quarterly estimates, requires a strict payment schedule. All too often we see business owners put their estimated tax payments on hold and pay other liabilities first. This causes a financial stress when their actual return is being filed, and there is a balance due. Once they fall behind, catching up with the past tax bill and current estimates can be extremely difficult.

Transitioning to an S Corporation may ease some of these budgeting emergencies by getting the owner on a systematic payroll schedule, as well as building up tax withholding throughout the year.

Table 1. Importance of having the right entity in place

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>Limited Liability Partnership (LLP)</th>
<th>Limited Liability Company (LLC)</th>
<th>S Corporation</th>
<th>C Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong># of Owners Allowed</strong></td>
<td>1</td>
<td>2 or more</td>
<td>1 or more</td>
<td>1 – 100</td>
<td>1 or more</td>
</tr>
<tr>
<td><strong>Liability Protection?</strong></td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Tax Filing Requirement</strong></td>
<td>Schedule C included on personal tax return</td>
<td>Form 1065 (separate tax return)</td>
<td>Schedule C, Form 1065 or 1120S depending on elections</td>
<td>Form 1120S (separate tax return)</td>
<td>Form 1120 (separate tax return)</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>at individual level</td>
<td>at individual level</td>
<td>at individual level</td>
<td>at individual level</td>
<td>at corporate level</td>
</tr>
<tr>
<td><strong>Compliance</strong></td>
<td>Less complex</td>
<td>Less complex</td>
<td>Less complex</td>
<td>More complex</td>
<td>More complex</td>
</tr>
<tr>
<td><strong>Advantage</strong></td>
<td>Simple to set up and maintain</td>
<td>Freedom from many regulations</td>
<td>Can choose to be taxed as partnership or corporation</td>
<td>Profits passed through are not subject to self-employment tax</td>
<td>Ease of transfer of ownership</td>
</tr>
<tr>
<td><strong>Disadvantage</strong></td>
<td>Unlimited liability</td>
<td>General partner personally liable for actions of other partners</td>
<td>More expensive to create</td>
<td>More annual administrative duties</td>
<td>Double taxation of profits</td>
</tr>
</tbody>
</table>
On the other hand, electing to be a C Corporation can limit the ultimate cash that makes it into the owner’s pocket. Why is this? Because profits are taxed at the corporate level, at a maximum rate of 35%. The profits that are left after corporate tax are then taxed again as dividends when the owner(s) distribute them from the company. This results in double taxation of profits, making C Corporations less attractive than other entity selections. The double taxation effect can be minimized by paying bonuses to owners at the end of the year, thus driving down profit, and ultimately, the tax at the corporate level. With better entity alternatives available, and the risk of double taxation, C Corporations are rarely utilized in audiology practices.

Avoid mixing business with pleasure

Commingling personal and business expenses can have a number of negative consequences. Taxing agencies, such as the IRS and your state revenue department, discourage combining the two as it often leads to the deduction of personal expenses on your business tax return. This can lead to serious penalties by the taxing agencies, and/or the possibility of legal action against you.

Allocating business funds to pay personal expenditures also ties up important operating capital, limiting your business’s growth opportunities—and the ability to meet its debt obligations. This drain on cash often leads to increased debt loads, threatening the long-term viability of the business.

Legally, personal expenditures paid through a corporation may pierce the corporate “veil.” In other words, the legal protection you’ve created, through your entity selection, could be compromised if you mix personal and business expenses. In the event of a lawsuit against your business, an opposing attorney may subpoena the business’s bookkeeping records, thereby exposing the combining of business and personal expenses. This can leave your personal assets vulnerable to a lawsuit.

Rely on professionals

Surrounding yourself with a knowledgeable network of professionals (attorney, CPA, financial advisor, banker, etc.) is the best recipe for success when setting up and maintaining your entity. Going at these tasks alone can be both overwhelming and time consuming. Relying on your professional network allows you to spend more time on revenue-generating tasks.

Your professional network should be comprised of people you trust, and that are responsive to your needs. If it takes them a number of days to return your phone call or email, try working together to set a certain level of expectation. If they continue having trouble accommodating your needs, search for a new professional.

Your CPA should be able to help you navigate the tax implications of each entity type. He or she should also provide tax planning and annual compliance services, such as tax return preparation and other annual filing requirements that may be imposed by your state taxing agencies.

Utilizing an attorney who specializes in entity selection and formation is highly recommended. An attorney will ensure all the proper documents have been completed and filed. The cost of these services typically range from $500 to $2,000, depending on the complexity of the organizational documents, and what you are trying to achieve. Online services are available for business owners to prepare some of these documents themselves, however extreme caution should exercised if you are doing any of these tasks yourself. An improperly set up entity can create future legal problems, and with that, headaches.

Maintenance tips

Once your entity is set up, you will have to attend to annual compliance tasks. Depending on your entity selection, annual meetings and minutes may be required. All entities require an annual tax filing with the IRS, and most states require you register the entity every year.

Corporations have the most strict guidelines to follow requiring articles of incorporation to be filed, adopting bylaws, electing a board of directors, holding annual meetings, and keeping minutes of the meetings and changes in the organization.

It’s important to remember that the state your entity is organized in may have additional filing requirements beyond the federal requirements. Often, these filing requirements can be completed online.

Detailed records of organizational documents, tax filings and annual renewals should be compiled and stored in a safe place. A request may be made to see these documents on numerous occasions throughout the year and life of your business, such as:

- **Lenders** – if you are requesting a loan from a lender, they may request the organizational documents of the entity to ensure they have a complete understanding of how it was formed and how it is owned, to best protect their interests. Further, they will undoubtedly request prior tax returns
and other annual compliance filings to verify the current standing of the legal entity, and its ability to pay back a loan.

- **Potential buyers/owners** – a party looking to acquire your business or join in ownership with you, will request a number of documents during their due-diligence process. Organizational documents and prior tax returns will assist them in determining how the business was organized, and provide insight on the business’s financial health.

- **Tax preparers** – when a business enlists the assistance of a CPA to prepare the annual tax return, organizational documents will likely be requested to ensure the tax return is prepared properly. The organizational documents contain important information that is required on tax returns, such as ownership percentages, date of formation and business identification numbers. Prior tax returns will also be requested if you are transitioning to a new tax preparer.

More business owners are relying on electronic storage options, such as computers or online document storage websites, to maintain this important financial information. This allows you to access the information at any time from your computer, which can speed up the document request process with a third party.

### If your entity has multiple owners, keep these tips in mind

Multiple owners in a business can create both opportunities and challenges. From inception, a business with multiple owners is typically set up more carefully by using knowledgeable professionals to ensure that the best interests of all owners are taken into consideration.

From a taxation standpoint, more attention is paid toward separating business and personal expenses when multiple owners are monitoring the expenditures. More timely tax filings are also common among multi-owner businesses because the tax results most often impact their personal tax filings.

Some challenges multi-owner businesses may encounter are agreement on how the business should be run. When setting up the entity, organizational documents should address how decisions are made, ownership percentages, dispute resolution, and buyout provisions. Not addressing these issues on the front end can lead to a breakdown in communication between the owners, and increases the potential of dissolving the business, along with high legal fees.

Also, keep in mind that the actions of your business partner(s) can impact your personal liability. Going into business with another person may subject you to liability if they are negligent or make a business decision that negatively impacts you.

### When multiple entities might be a good idea

There might come a time in your business when having multiple entities set up is essential. Some practices choose to have multiple entities in place for each location. This is only recommended if ownership will be different for each entity/location. Avoiding separate entities can save tax preparation costs and administrative time related to keeping multiples sets of books, bank accounts, payroll accounts and sales tax filings.

If a building is purchased for your practice, setting up a separate entity (such as an LLC) is highly recommended. Having the property in a separate entity can provide legal protection from a potential lawsuit, in the event someone is injured while on your property.

Placing real estate in an S Corporation is not advised as it can have negative tax implications when you remove the property from the entity, or if there is a death of a shareholder. If your S Corporation currently holds real estate, now may be the best time to remove it from the corporation due to the depressed real estate market. Careful planning and communication with your attorney and CPA should be exercised when acquiring a building to ensure proper entity selection and accurate recording of the financial transaction.

### Review your entity selection on a periodic basis

Your entity selection isn’t always a “do-it-once-and-forget-it” decision. As your business grows, a number of evolving factors can change which entity best suits your business, such as:

- **Number of owners** – a change in ownership can require a change in entity type. If you are a sole proprietorship and want to add another owner, switching to an entity that allows multiple owners will be required. Further, your entity needs may change if the new owner is a business entity, and not an individual that an LLC may accommodate.

- **Profitability** – the profitability of your business can impact your long-term entity selection. Sole proprietorships, LLCs and partnerships can typically withstand a certain amount of profitability (typically under $100K) before a corporation may be a better fit from a taxation standpoint. A number of factors, such as self-employment tax, tax preparation
fees and organizational costs, should be considered when deciding which entity is more costly. A CPA can typically prepare an entity comparison calculation to determine which may be the best value.

- **Employee benefits** – as your business grows, the need to provide employee benefits (health insurance, flex-spending accounts, retirement options, etc.) may be needed to retain or attract good talent. Offering those same benefits to owners can impact their deductibility, depending on your entity selection. Certain entities favor employee benefit offerings to owners, such as corporations.

**Be careful in your entity selection**

Do not take your entity selection decision lightly. How you organize your business will impact the amount of time dedicated to administrative responsibilities, the relationship between you and your partners, and ultimately, the cash that goes into your pocket after paying taxes. Candid discussions should take place with your trusted business advisors to ensure the entity you’ve selected will meet your current needs and future expectations.

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