



## Starting a Medical Practice: What Entity Works Best for You?

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Starting a medical practice is an exciting new opportunity, but, like with many new opportunities, you will face a number of important decisions before you can open your doors to patients. One of the early decisions you will have to make is to choose the type of entity you want to use for your practice.

For many years, businesses had limited options, and those options came with significant pros and cons. In the past thirty years or so, the law has evolved to expand the number of choices that business owners have in choosing the best entity for their businesses. Now, there are several entity options that not only provide business owners with limited liability for the debts and obligations of a business, but also avoid income taxes at the entity level and the owner level (also known as double taxation).

As a result, there are a number of options with respect to business entity from which to choose. This article provides an overview of the two of the most commonly used entities for medical practices: the S-corporation and the limited liability company (LLC). Both types of entities provide limited liability protection with respect to the debts and liabilities of the business that are not personally guaranteed, and also pass through tax treatment, but there are some differences that should be considered. It is also important to note that a business entity will not shield an individual from his or her own personal professional liability.

Incorporating your practice is a very established practice and procedure, but in order to avoid double taxation, a corporation must elect to be taxed as an S-corporation and file the necessary paperwork with the IRS in a timely fashion. Any corporation formed under Alabama (or other applicable law), including a professional corporation, may elect to be an S-corporation if it meets certain requirements and restrictions established by the IRS in regards to S-corporations. For example, an S-corporation cannot have more than 100 shareholders, and, with few exceptions, the shareholders have to be individuals and US citizens or legal residents. While many of the requirements are not likely to be difficult for a medical practice to meet, they may tie your hands as to flexibility in structure. An S-corporation is limited to one class of stock (although there may be voting and non-voting stock), and all distributions must be proportionate to stock ownership. Yet, despite the somewhat restrictive nature of an S-corporation, many people enjoy the predictability and structure that a corporation provides. Additionally, shareholders providing services to the S-corporation may also be considered employees for tax purposes, whose wages are subject to withholding, which may help limit self-employment tax liability.

If you chose to incorporate your medical practice, you will need a certificate of incorporation, which sets forth the information required to form a corporation under applicable law, and bylaws, which set out the various governance provisions of the corporation regarding directors, shareholders, meetings, officers, and the like. Additionally, you will likely put in place a shareholders' agreement, which may restrict the transfer of shares in the corporation and other similar agreements of the shareholders. From a management perspective, an S-corporation is managed by a Board of Directors elected by the shareholders, and the Board of Directors may delegate powers to appointed officers.

The other common entity choice for medical practices is the LLC. Unlike an S-corporation, there is a tremendous amount of flexibility in how the LLC is managed and structured. An LLC is formed by the filing of a certificate of formation, but the operating agreement of an LLC, which is the operative document that governs the management and other affairs of the LLC, is a contract among the members of the LLC. Alabama statutory law provides certain default rules for an LLC in the event the LLC does not have an operating agreement or the operating agreement does not address certain issues, but with certain exceptions, most of these default rules can be rejected by the operating agreement. The parties, therefore, may be much more creative in determining the management and financial structure of the LLC. Unlike an S-corporation, an LLC is flexible as to the allocation of income, gain and loss, as well as the manner of distributions. A disadvantage, however, is that members of an LLC are not considered employees for tax purposes, and distributions are subject to self-employment tax.

From a management perspective, an LLC can structure itself to operate like a corporation, or it can be much more decentralized. By default, an LLC is managed by its members unless it chooses to be manager managed in its certificate of formation. The operating agreement can expand or restrict the power of the manager(s) to the extent desired by the members. Again, the scope and style of managing the LLC is a matter of negotiation and agreement among the members, so there may be a number of different possible management structures that can be established. While some people like the flexibility and creative possibilities that an LLC provides, others may be frustrated by the seemingly endless options and prefer the more established framework that an S-corporation presents.

Choosing the correct entity for your circumstances is one of the first steps in creating a successful practice. As you can see, there are a number of factors related to the choice of entity for a medical practice, and the right decision will depend on your particular facts and circumstances. Therefore, it is very important for you to consult with your legal and tax advisors before making any decisions regarding entity choice.



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