A LESSON FROM P.C.U.

One of the most common questions I receive from lawyers wishing to start their own law practice is what type of legal entity their law practice should be. With help from a couple of my CPA, tax attorney and business attorney friends, I set out to find out what type of legal entities are most frequently used by attorneys to establish their own practice. The two biggest issues, at least for me, have always been liability and tax consequences. Several types of business organizations frequently used by law firms include sole proprietorships, professional corporations, professional limited liability companies, and professional limited liability partnerships. This article is not an endorsement of one type of vehicle for doing business over another, nor does it discuss general partnerships which have the same unlimited liability as a sole proprietorship and offer no liability protection to their partners. The following is a discussion of some of the options available to attorneys who are considering starting their own practice:

Sole Proprietorship:

The simplest method of organizing a solo practice is to establish a sole proprietorship. The most important drawback is that liability for a sole proprietor in unlimited. Law practices operated as sole proprietorships are not subject to the Tennessee franchise and excise tax. For federal income tax purposes, income of a sole proprietorship is taxed directly to the individual proprietor. In comparison to other business organizations, a sole proprietor may not be able to reduce earnings subject to social security tax as much as with other methods of doing business such as a professional corporation. Doing business as a sole proprietor may also affect the extent to which one may obtain tax deductions including life insurance (under limited circumstances), medical expenses, and disability insurance among others.

Professional Corporation (P.C.):

As of 2004, it was estimated that 50% of the law firms in America were professional corporations. This is due to the fact that professional corporations have existed much longer than other types of limited liability business entities. The Tennessee Professional Corporation Act (TPCA) is codified at T.C.A. § 48-101-601 et seq. A P.C. is operated the same as any other corporation with all provisions of the Tennessee Business Corporation Act (Act) applicable except to the extent that the Act is inconsistent with the TPCA. However, a professional corporation must actually render professional services or it must cease to operate as a P.C. As a Professional Corporation, attorneys can elect “C Corporation” or “S Corporation” status for the purpose of taxation. Professional corporations are also subject to taxation by the Tennessee franchise and excise tax. Regarding the issue of liability, a lawyer who is a shareholder of a P.C. has the same liability as a shareholder pursuant to the Tennessee Business Corporations Act. A lawyer who is an employee of a P.C. is liable for his or her own negligent or wrongful acts or omissions.

Professional Limited Liability Company (PLLC):

The PLLC is a hybrid of a corporation and a partnership allowing for the limited liability of a corporation and the opportunity to be taxed, for federal income tax purposes, as a sole proprietor (if a single member), partnership, or corporation. The codification of the professional limited liability company entity is located at T.C.A. § 48-248-101 et seq and T.C.A. § 48-248-1101 et seq. Through these acts the State of Tennessee “has imposed on professional LLCs structural limitations roughly equivalent to those imposed on [professional corporations] organized in Tennessee.” Some of these structural limitations are different than a normal LLC and include name requirements and limiting eligible members of a PLLC. PLLC’s are also subject to the Tennessee franchise and excise tax. Although a PLLC provides a liability shield with respect to some liabilities, a member of a PLLC remains liable for his or her own negligent acts or omissions.

Professional Limited Liability Partnerships (PLLP):

This type of entity is a “sub-species” of the general or limited partnership providing its partners the ability to obtain the limited liability of a PLLC without having to go through the process of registering as a PLLC and creating a new organizational and governance structure. This may appeal to attorneys of small firms who are already involved in general partnership and who do not want to go through the process of becoming a PLLC. Instead, the partnership may register as a PLLP with the state. The application process is available at T.C.A. § 61-1-1001 et seq. Just like a PLLC and P.C., a PLLP is subject to the Tennessee franchise and excise tax.

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3 See T.C.A. § 67-4-2001 et seq.
4 Dorn, supra note 2, at 24.
5 Id.
6 T.C.A § 48-101-602.
7 T.C.A § 48-101-623.
9 See T.C.A. § 67-4-2001 et seq.
10 T.C.A. § 48-101-621.
11 Id.
12 Rutledge et al., supra note 9, at 136, n.b.
14 See T.C.A. § 67-4-2001 et seq.
15 T.C.A § 48-249-1119.
16 Rutledge et al., supra note 9, at 136.
17 Id.
18 T.C.A. § 61-1-1005.
19 See T.C.A. § 67-4-2001 et seq.