

Professional Group Practice Options

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There are many ways licensed professionals (such as attorneys and dentists) can work together in group practice. In California, the available mechanisms are Corporations, LLPs (limited liability partnerships), Partnerships, Group Solos (expense sharing), and Subleases.

These mechanisms also can be combined in various ways to meet more of the group's goals. Other entities such as LLCs (limited liability companies) and PAs (professional associations) are not available to California professionals, and LLPs are available only to California attorneys, CPAs, architects, engineers, and land surveyors.

Those considering group practice should have detailed discussions to confirm they have complementary individual and group goals before looking at any other specifics. The best combination also requires review of tax issues, limited liability concerns, compensation, income and expense allocations, and succession planning, with the group's long term viability and success being the ultimate target.

Each entity and combination has its own advantages and drawbacks (Subleases discussed separately), starting with an Executive Summary:

Entity Combination and Benefits	LLP *	Corporation	Partnership of Corporations	Group Solo of Corporations **	Sublease **
Simplicity	😊😊😊	😊😊😊	😞	😊😊	😊😊😊😊
Flexibility	😊😊	😞	😊😊😊😊	😊😊😊😊	😊😊😊😊
Autonomy	😊😊	😞	😊😊😊	😊😊😊😊	😊😊😊😊
Cost	😊😊	😊😊😊	😞	😊😊	😊😊😊😊
Limited Liability	😊😊😊😊	😊😊😊😊	😊😊😊😊	😊😊😊😊	😊😊
Current Tax Benefit	😞	😊😊😊	😊😊😊😊	😊😊😊😊	😞
Non-Competes	😊😊😊😊	😊😊😊😊	😊😊😊😊	😞	😞
Succession Planning	😊😊😊	😊😊	😊😊😊😊	😞	😞

* Assumes no S election. LLPs with an S election are like Corporations but with less simplicity and higher cost.

** When shared employees are paid directly by only one professional, Group Solos and Subleases hide the risks of employment law violations (e.g., benefits, worker's compensation, discrimination claims).

Simplicity, Flexibility and Autonomy: A Partnership of Corporations is the most complex combination, since three separate entities and tax returns are required, but that complexity provides the best avenue to reduce taxes and professional discord, and increase autonomy, expansion and third party sale opportunities. A Group Solo of Corporations provides more autonomy, is less complex (with one less entity and tax return), and has similar flexibility benefits. A single Corporation or LLP is the simplest structure, but professionals can no longer act independently, and tax/ financial/ professional disputes increase with identical treatment of dissimilarly situated professionals (less so for LLPs than Corporations).

Cost: A new Corporation or LLP without buyout arrangements (on death, disability, loss of license or other depart-

ure) is the least expensive option (\$2,100 or more; add the \$800 1st year franchise tax for LLPs). A single Corporation or LLP with buyout arrangements costs about the same as a Partnership or Group Solo if professionals already have personal Corporations in place (\$9,000 or more; add \$800 for LLPs). Partnerships or Group Solos without existing personal Corporations require \$2,100 or more per new Corporation. Annual tax returns and regulatory compliance typically cost \$2,000 and up per Corporation or LLP and \$1,200 and up per Partnership.

Limited Liability: Insulating personal assets from liability created by employees, managers, and other professionals is of paramount concern, so a limited liability entity must exist somewhere between the professional and the group. This can take the form of a Corporation, LLP, Partnership

of Corporations, or Group Solo of Corporations. Single person LLPs (and therefore Partnerships or Group Solos of one-professional LLPs) are not available in California.

Tax Benefits: In general, Corporations (whether alone or combined with a Partnership, LLP, or Group Solo) provide the most tax benefits. Tax benefits of various combinations are highly dependent on the types of income and expenses incurred, and the professionals' financial goals and personal tax situations. Issues to be considered include (among others) availability of specific tax deductions and tax-free benefits, reduction of payroll taxes, and choice of fiscal year. The sometimes counter-intuitive tax ramification of anticipated buyouts, buy-ins, and earn-ins also must be considered.² The tax issues are relatively easy to understand, but each professional must talk to its own accountant before choosing the ultimate form of group practice.

Disparate Tax Approaches: If each professional benefits equally from deductible expenses and benefits, and is equally aggressive in claiming specific deductions and benefits, then a single Corporation or LLP can work. However, when professionals are at significantly different stages of their careers, will receive significantly disparate values from deductible expenses and benefits, or differ significantly on how aggressively to deduct expenses and benefits, a Partnership or Group Solo of Corporations is a better approach.

Compensation & Profit: If any professional believes their overall contribution to the group practice is not adequately addressed in the compensation and profit structure, the group will not survive. Some professionals may work less time, attract less business, produce less income, generate higher expenses, or have competing or conflicting business ventures. Circumstances change over time, and so too will the conflicts and differences, so compensation formulas need to adjust to changed circumstances. Will base pay be fixed, based on experience/ billings/ collections, or some combination? Will profit distributions be based on ownership, business generation, or some combination? LLPs, Partnerships, and Group Solos are far better able to address these issues than a single Corporation.

Non-Compete Issues: California permits non-compete agreements (including reasonable employee non-solicitation and similar provisions) when associated with a Partnership, Corporation, LLP, or practice buyout.³ There is no such protection in a Group Solo practice except on a practice buyout. Trade secrets and proprietary information have the same level of protection no matter what entity combination is used, although the group itself may own that information.

Succession Planning / Buyout Values: Setting a fair purchase price and tax allocation for practice buyouts (on death, disability, loss of license or retirement) generally is

only possible with LLPs, Partnerships, and Group Solos, as opposed to Corporation stock buyouts. This is because stock buyouts are not tax deductible, dropping the fair market value of stock to approximately $\frac{2}{3}$ of an LLP, Partnership, or Group Solo interest, and is a major problem for a practice with significant goodwill or equipment value.

Subleases: Subleases are the least costly (\$1,500 or more) and most simple approach to group practice. A Sublease also maintains a high degree of tax, financial, and practice autonomy. However, it has no particular limited liability² or tax benefit, income/ expense/ profit sharing, succession planning, or non-compete protection. It also does not provide any security to remain on-site beyond the Sublease term, or easily allow for a practice sale to a third party.

Recommendations: A Partnership of Corporations generally is preferred for practices with significant buyout value. Disparate time commitments and income generation are easily accommodated, different tax and financial incentives and approaches are easily separated, buy-ins are tax deductible, buyouts are at full value, and each professional maintains limited liability. Formation and maintenance costs are higher than that of a single entity, but the overall tax savings and additional group stability are worth far more in the long term.

A single Corporation or LLP has lower formation and maintenance costs. However, this approach works well only if each professional (1) receives substantially similar tax benefits, (2) shares the same posture on tax avoidance, and (3) has an insignificant buyout value. Also, tax benefits are more limited for LLPs than Corporations.

Group Solos are unlikely to have significant advantages over a Partnership or Sublease. They have similar benefits to Partnerships, but risk (1) having an undesirable replacement imposed on the remaining professional, (2) violating employee benefits and employment practices laws due to the false impression that only one professional is the employer, (3) being viewed by the landlord as an unapproved Sublease (risking an eviction or higher rent), (4) creating de-facto partnership liability by co-signing for group obligations, or sharing employees or signage, and (5) intra-professional poaching of clients/patients, staff, or referral sources. These problems subside if the professionals have no significant (goodwill or equipment) buyout value, keep separate work areas and employees, do not co-sign on any significant group obligation, and receive formal landlord approval of the arrangement. However, this situation is nearly identical to a Sublease, which is significantly less expensive than a Group Solo.

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experts. A structured approach, where the trial judge has a list of questions for each of the four stages makes this job a lot easier and it avoids the judge just imposing her or his own opinion or simply choosing one expert over another. ■

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ENDNOTES

- 1 *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).
- 2 See, *Santa Barbara Lawyer Magazine*, *Criminal Justice* column, February, March and April, 2012.

Daniel C. Murrie, *et al.*, *Are Forensic Experts Biased by the Side That Retained Them?* *Psychological Science*, August 22, 2013. From the abstract: ¶In this experiment, we paid 108 forensic psychologists and psychiatrists to review the same offender case files but deceived some to believe that they were consulting for the defense and some to believe that they were consulting for the prosecution. Participants scored each offender on two commonly used, well-researched risk-assessment instruments. Those who believed they were working for the prosecution tended to assign higher risk scores to offenders, whereas those who believed they were working for the defense tended to assign lower risk scores to the same offenders; the effect sizes (d) ranged up to 0.85. The results provide strong evidence of an allegiance effect among some forensic experts in adversarial legal proceedings.

- 4 *Strengthening Scientific Evidence*, National Research Council, the National Academies Press (2009)
- 5 *The Reference manual on Scientific Evidence 3d Ed.* Federal Judicial Center (2011).

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Conclusion: Group practice can provide professionals with tremendous economies of scale and professional synergies that are unavailable in solo practice. However, it is crucial for the group to examine and discuss respective practice styles, tax approaches, long term goals and succession plans, and compare those results with the available mechanisms and combinations, before choosing their ideal form of group practice. ■

Mr. Olson is an attorney focusing on business organizations since 1986 and professional practice transitions since 1992.

ENDNOTES

- 1 Estimates are based on typical comprehensive legal services provided by the author, do not constitute a representation of actual cost for specific client situations, and do not include other professional or rush filing fees. Costs also vary among individual practitioners, service levels, and State of practice.
- 2 See *Tax Ramifications of Sweat Equity in Professional Partnerships*, *Santa Barbara Lawyer*, January 2012.
- 3 *Business and Professions Code § 16601(a) and Loral Corp. v. Moyes* (1985) 174 Cal. App. 3rd 268.

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and he is an avid soccer player. This summer he and I did something that for me was motivated by the unexpected death of Ed Bullard. I was at Judge Bullard's funeral services, and they were talking about the fishing trips that Ed would take, where not a lot of fishing happened but there were a lot of good times. And so I thought, ¶I can't wait to retire to do the things I wanted to do. I better do them now, because life has a funny way of turning. And so the next week my son and I went fly fishing on the lower Owens River out of Bishop for three days. Later on in the year, we went with a couple of friends and hiked 60 miles in the Sierras. I had never hiked Yosemite before, and it was a glorious experience.

In my spare time, as soon as my wife leaves to run an errand, I like to jump on my bicycle and ride on the roads around Orcutt.

JG: Thank you for taking the time to talk with *Santa Barbara Lawyer*. The entire Santa Barbara County Bar wishes you the best of luck in dealing with all the very serious challenges you are facing.

DP: Thanks very much. ■