Choosing the correct structure for your veterinary practice is an important decision with consequences reaching far into the future. Selecting your practice structure is definitely not a “do it yourself” project. Substantial tax, legal and accounting expertise is required. Veterinarians nevertheless need to stay active in the process to ensure the experts’ narrow technical proposals get folded into a coherent plan that reflects your needs and goals.

• It’s Mostly About Tax. Tax considerations are the primary drivers in choosing a legal structure for a veterinary practice. The two key aspects are taxation of income/profits and taxation upon the sale or transformation of the practice. Don’t paint yourself into a corner by choosing a business structure without establishing a succession or exit strategy. Exit strategies should focus not only on your richly deserved retirement, but also on contingencies such as death or disability. Since the transformation of an existing business structures in anticipation of a sale or the buy-in of a new partner usually triggers adverse tax consequences, it is usually better to choose an initial structure with the necessary flexibility to handle new arrivals, departures and divestitures at minimum fiscal cost.

• Liability Shield. In some structures such as partnerships, the owners are personally liable on their individual assets for the debts of the business. In others their personal assets generally are not at risk. Business structures, however, do not insulate veterinarians from liability arising from malpractice claims. But the shield works for almost all other claims, which in our litigious society are increasingly frequent. Unless you are an equine or food animal veterinarian, you generally have greater exposure to claims from your client’s “slipping and falling” in your hallway, than malpractice.

• Flexibility and Formalities. Some structures allow more management flexibility and/or are less burdensome to administer than others. Veterinarians generally tend to ignore formalities which is a serious mistake. Courts regularly have looked past the liability shield and held owners personally liable when the owners have failed to observe the formalities separating their personal affairs from those of the practice entity.

AN OVERVIEW
The accompanying table compares the more common business structures from a liability, management and formality perspective (in simplified form). Following is a brief and much simplified overview of the tax characteristics of each entity.
1. **Sole Proprietorships.** Since sole proprietorships are not legally separate from the single owner, there is no separate tax return. The practice’s profits are included in owner’s total income and are taxed at his ordinary income tax rate. In addition to federal and (if applicable) state income tax, the owner must also pay self-employment tax equivalent to the payroll taxes due as if the owner were an employee of the practice.

Upon the sale of the sole proprietorship practice’s assets, the IRS will recapture all depreciation/amortization deductions taken by the owner/seller thereof and tax such amount at the seller’s ordinary income tax rates. In the unlikely event that any gain remains on the assets (after adding back any depreciation/amortization to their respective “bases”) they will be taxed at the lower 20% long term capital gains rate (assuming the relevant holding period is met).

The buyer receives a “step-up” (increase) in his basis in the assets proportional to the amount of (purchase price allocated thereto) allowing him to re-depreciate/amortize them. Thus, asset sales usually are a better deal tax-wise for the buyer than for the seller, and all other things being equal, buyers will prefer to purchase assets rather than stock (in a C corp).

2. **Partnerships.** Partnerships are “pass-through” or “flow-through” entities for tax purposes, meaning that each partner includes in his own taxable income the profits (or losses) of the partnership, which are taxed as ordinary income at the partner’s individual rate (much like the owner of a sole proprietorship). Note that each partner’s share of partnership income is taxable each year, whether such share was distributed to the partner or retained in the partnership. If the latter, then the partner may not have the cash to pay the tax.

A consequence of the pass-through principle is that the sale of partnership interests are treated for tax purposes similarly to the sale of the underlying assets of the partnership (i.e., the assets are subject to depreciation recapture as in sole proprietorships).

3. **Corporations.** All corporations must file separate tax returns.

• **“S” Corporations.** “S” corporations are corporations that elect to be taxed as a partnership. As “pass-through” entities, profits will be taxed in the hands of the shareholders whether distributed or not. An advantage of S corporations is that shareholders may take a portion of their profits as “S corporation profit,” free of payroll or self-employment tax (i.e., subject only to income tax). Profit corresponding to what the veterinarian shareholder would have earned as an employee is subject to payroll taxes in addition to income tax. (Sole proprietorships on the other hand must pay self-employment tax on all profits.) S corps are popular with veterinarians for this reason.

• **“C” Corporations.** Plain vanilla” corporations (called “C” corporations to distinguish them from “S” corps) are not “pass-through” entities and are subject to corporate income tax, usually at the 35% rate for veterinary practices. Distributed profits (dividends) are taxed as ordinary income in
the hands of the shareholders. This “double taxation” discourages the distribution of C corporation profits. On the plus side, C corp profits are not taxed until distributed, pension plan contributions are not subject to the S corp limits, and employee-shareholders’ health benefits are not taxed. Veterinarians wishing to maximize their benefits will choose a C corp over an S corp.

If the holding period requirement has been met, the sale of C corporation stock is taxed at the favorable 20% long term capital gains rate. The buyer does not receive a step-up in the basis of the underlying assets since he is buying the corporation stock. (The buyer can under certain circumstances elect to treat the transaction as an asset sale for tax purposes (a.k.a. a Section 338 election).)

4. **Limited Liability Companies.** Limited Liability Companies are very quite tax-wise. Single member LLCs can elect to be taxed either as a C corp or a sole proprietorship. Multi-member LLCs can elect to be taxed either as a C Corp or a partnership. Unfortunately, not every state allows veterinarians for form LLC (ie, California).

5. **A Word Regarding Real Estate.** If the practice owns its own real estate it’s better placed in a separate entity held by the owner(s) or held individually by the practices owner(s). This allows the owners to receive rent (which will be deductible from the practice’s income). Moreover, placing the real estate and the practice in the same legal entity frequently leads to problems because the buyer can’t afford to buy the real estate in addition to the practice.

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Choosing the correct business structure for your practice is important. Don’t treat it lightly.
### SIMPLIFIED PARTIAL COMPARISON OF DIFFERENT BUSINESS STRUCTURES

(Ex tax issues)

<table>
<thead>
<tr>
<th>Structure or Entity Type</th>
<th>Issue</th>
<th>Liability</th>
<th>Formalities/Flexibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole Proprietorship</td>
<td>No entity; business co-mingled with personal assets</td>
<td>No liability shield</td>
<td>None. Just open your door and you’re in practice!</td>
</tr>
<tr>
<td>Corporations (“C” or “S” Corp) A Professional Corporation (“PC”)</td>
<td>Identical to a C Corp in all respects except that only members of the same profession (e.g., vets) can own its shares</td>
<td>Shareholder not liable for debts/liabilities of corporation (unless “corporate veil is pierced” because shareholders fail to separate their personal affairs from corporations (e.g. by ignoring formalities)</td>
<td>Must file documents with state secretary of state. Formalities are the most cumbersome of all entities. Less formal flexibility re management/profit sharing issues</td>
</tr>
<tr>
<td>Limited Liability Company (LLC)</td>
<td>(Created to provide more management flexibility than S Corp and “pass through” tax treatment)</td>
<td>Member not liable for debts/liabilities of LLC (subject to piercing corporate veil doctrine)</td>
<td>Must file documents with state secretary of state; but management, profit sharing can be flexible.</td>
</tr>
<tr>
<td>General Partnership⁴</td>
<td></td>
<td>Partners liable for debts/liabilities of Partnership; <strong>no liability shield</strong></td>
<td>Must file documents with state secretary of state, but management; profit sharing can be flexible.</td>
</tr>
</tbody>
</table>

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1. Salvation lies in adequate malpractice insurance.

2. The basis of an asset is it’s original cost to the owner, as adjusted pursuant to IRS rules.

3. Because veterinary practices usually are personal service corporations.

4. Limited partnerships are different from general partnerships. An LLP generally is formed among several limited partners who are normally passive financial investors and one general partner responsible for managing the enterprise. Limited partners normally are not liable for the debts/liabilities of the LLP, whereas the general partner is. Contrary to the motion picture business, real estate or oil and gas exploration, LLPs may not be appropriate for a veterinary practice where all the members are actively engaged in the enterprise.