

DC Bar Lunch + Learn: Business Entity Formation for Law Firms

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Scope + Limitations

- Survey of entities focused on law firms
- Disclaimers
 - Not tailored, not legal advice and should not be relied upon
 - Expertise is corporate law, not tax and not professional ethics
 - Licensed DC and MD only

Outline for Discussion

- Overview
- Select Entity Types
- Practical and Procedural Aspects
- Takeaways

General Background

- DC Code Title 29 DC Business Organizations Act
- Primary selection drivers
 - Liability (unlimited or limited)
 - Taxation (double or single)
 - Operational ease
 - Structural applicability and flexibility
 - Costs (initial and ongoing)

Special Circumstances for Law Firms

- Professional Liability
- Requirements and limitations in requisite entity forms (PC, PLLC)
- Financing
- Ethical rules

Select Entity Types

- **Sole Proprietorship (Sole Prop)**
- **General Partnership (GP)**
- **Limited Liability Partnership (LLP)**
- **Professional Corporation (PC)**
- **Professional Limited Liability Company (PLLC)**

Sole Proprietorship: Definition

- A business owned and operated by an individual, who is personally responsible for its debts
 - Not a legal entity, unincorporated
 - Exists automatically

Sole Proprietorship: Characteristics

- Easy formation and operation
 - Flexible
 - Minimal requirements apply
- No separate legal person
- ***Unlimited personal liability***
for business debts

Sole Proprietorship: Advantages

- **Ease**
 - No filing to establish
 - No corporate formalities generally
 - No separate bank account required
 - Easy to operate, complete control
- **Entitled to all profits**
- **Tax reporting on individual return**

Sole Proprietorship: Disadvantages

- ***Unlimited personal liability***
- Self-employment taxes; no unemployment benefits; limitations on deductible items
- Life of business tied to life of owner

Partnerships Generally: Definitions/Authority

- Governed by "Uniform Partnership Act of 2010" Title 29 Chapter 6
- General Partnership (GP)
 - “Partnership’ means an association of 2 or more persons to carry on as co-owners a business for profit.” § 29–601.02(09)
 - Exists automatically
- Limited Liability Partnership (LLP)
 - A Partnership that has elected to become an LLP by filing Statement of Qualification per § 29–

GP: Characteristics

- Formation – no cost or filing required
- Operation – minimal legal requirements apply
- Flow-through taxation
- No separate legal person
- ***Unlimited personal liability***

LLP: Characteristics

- A special form of GP with limited liability
- Requires registration
- Flexibility in determining management, operations, profits
- Pass-through (federal and DC)

LLP: Advantages

- ***Limited liability***
 - Business acts
 - Malpractice of partners
- **Financial/Tax**
 - **Single taxation at owner level**
 - Allocation of income, loss, distributions
 - Pass-through for taxation

LLP: Disadvantages

- Bound by actions of partners
- Complex tax forms (e.g. partnership return on form 1065, K-1s, plus D65 in DC)
- Distribution restrictions per § 29–610.02
- Self-employment taxes; no employee owners
- Transfer restrictions

Corporation: Definition/Authority

- A separate legal entity that has been incorporated through a registration process established by law
- Corporations governed by “Business Corporation Act of 2010” Title 29 Chapter 3, but Professional Corporations also governed by “Professional Corporation Act of 2010” Title 29 Chapter 5

Professional Corporation (PC): Definitions

- "Professional corporation" means a corporation organized under this chapter solely for the specific purposes provided under this chapter and which has, as its shareholders, only individuals who themselves are duly licensed to render the same professional service as the corporation." § 29–502(2).
- "Professional service" ...include[es] the services performed by certified public accountants, attorneys, architects, health professionals as defined..., and professional engineers. § 29–502(3).

PC: Characteristics

- Formation: 1 or more shareholders
- Directors: 1 or more
- Qualification requirement
- Transferability*
- Stability of perpetual duration
- **Double taxation**

* Subject to qualification

PC: Advantages

- ***Limited liability*** (but § 29–510 specifies no alteration to “liability arising out of professional service”)
- Transferability
- Stability, life not tied to owners’
- Employee owners
- Certain tax aspects

PC: Disadvantages

- Taxation at both corporate level (federal, DC form D 20 and possibly additional state) and owner level
- Complexity in operation
- Lack of flexibility
- Restriction on ownership

Limited Liability Company: Definition

- “A limited liability company (LLC) is a flexible form of enterprise that blends elements of partnership and corporate structures. An LLC is not a corporation; it is a legal form of company that provides limited liability to its owners...”

http://en.wikipedia.org/wiki/Limited_liability_company

- Authorized by individual state statutes
- Hybrid drawing on advantageous attributes of corporations and partnerships

Limited Liability Company: Authority

- DC requirement as to Professional Limited Liability Company (PLLC)
- § 29.101.02(38) “Professional limited liability company’ means a limited liability company organized under Chapter 8 of this title solely for the purpose of rendering professional services through its members, managers, employees, or agents.”

PLLC: Characteristics

- ***Limited liability***
- Highly flexible
- 1 or more members
- Report income and expenses of business on individual tax return; no separate tax return

PLLC: Advantages

- **Single taxation at owner level**
 - Simplified tax reporting for single member
 - Added complexity for partner return
 - Some tax deductions
- ***Limited liability***
- **Flexibility**
- **Potential simplicity**

PLLC: Disadvantages

- Flexibility and variety gives rise to need for legal and tax advisors to set up properly; operating agreement highly recommended
- Potential partnership tax complexities
- DC franchise tax potentially applicable
 - D30 for DC Unincorporated Business Franchise Tax (due April 15)
- No employee owners; self-employment taxes; no employee benefits

Other Considerations

- **Governing agreements important**
- **Respecting formalities, no comingling funds**
- **Jurisdiction**
 - Principal office
 - Tax consequences
- **Insurance**

DC Filing Requirements: Corporate and tax

- Corporate/Entity Registration
 - Form varies by entity
 - Filing fees streamlined
- DC Office of Tax and Revenue Registration
 - FR500 Combined Tax Registration
- Permitting and Licenses
 - Basic Business License
 - C of O/Home Occupation Permit
 - Other applicable permits/licenses?

Other Potential Filings/Requirements

- Trade Name and Naming
- Name Reservation
- Registered Agent
- Foreign Registration
 - § 29–105.03. Foreign registration statement. (9) A statement of the date it commenced or intends to do business in the District.

Ongoing Filing Requirements

- **Biennial Report**
 - Due April 1 every other year § 29–102.11
- **Tax/Franchise Filings**
 - Annual deadline depends on entity
- **Registered Agent**
 - Must maintain, penalties for failure

Summary + Chief Considerations

- Liability
- Tax consequences
 - Key to review with competent tax advisor
 - Consider specific jurisdictions (DC, other implicated state and federal)
- Administrative and financial costs
- Insurance

Additional Resources

- <http://dcra.dc.gov/book/just-starting-your-business>
- <http://dc.gov/page/doing-business-in-dc>
- <http://otr.cfo.dc.gov/service/business-tax-service-center>
- <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Small-Business-and-Self-Employed-Tax-Center-1>
- <http://www.wdcep.com>

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