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SMALL BUSINESS

The Accountant's Entity Guidebook

Ready to start your own accounting firm? Here's how to decide which entity type is best if when starting a new practice.

Nellie Akalp • Sep. 30, 2020

Because of the liability involved with running a professional accounting business, most business owners choose to structure their firms as a Limited Liability Company (LLC), a Professional Limited Liability Company (PLLC), a C Corp., or a Professional Corporation (PC). Some, however, still run their accounting firms as sole proprietors and partnerships. Here's what you should know about each.

Sole Proprietorships

A sole proprietorship is the simplest business entity to start. If you launch your new accounting business and are the only owner, you are automatically a sole proprietorship under the law. You don't need to register a sole proprietorship with your state, you simply get your accounting license and off you go!

With no corporate formalities or paperwork requirements, the sole proprietorship is a popular entity to start. Owners can even deduct most business losses on a personal tax return by attaching a Schedule C-Profit or Loss from Business form.

The downside of the sole proprietorship is the owner has no protection from the liabilities involved in running an accounting business. The sole proprietor is personally responsible for all of the business's debts and any lawsuits against your business which puts your personal assets at risk.

Partnerships

A partnership is a legal entity where two (or more) people run a business. Like the sole proprietorship, each partner owns a portion of the assets and liabilities of the business. A partnership agreement documents partner responsibilities, contributions, decision-making powers, dispute resolutions and more.

No matter what the partners' positions or contributions, all are equally liable for the actions of the partnership. If the business gets sued or cannot pay its debts, all partners are held responsible and their personal assets are at risk. Each partner is also contractually obligated to anything a partner agrees to in the business name.

Limited Liability Company (LLC)

For small professional companies, the LLC has risen in popularity. The LLC structure offers owner/operators (called members in the LLC) the liability protection of a corporate structure but entails fewer administrative compliance requirements than a corporation.

The main function of the LLC is to limit the personal liability of the members from the financial and legal actions of the business. If the firm is sued in court or can't pay its debts, you and all members retain personal liability protection. That means your personal assets are off limits as long as your business has been operating in good standing and complying with the laws of the state.

Be aware, not all states allow licensed professionals to structure as an LLC, including accountants. Many states believe professionals should have personal liability in case of professional malpractice. Also, because the LLC has fewer compliance regulations and management formalities, it's more difficult to monitor an LLC. States also want to make sure all members of the LLC are properly licensed.

Professional Limited Liability Company (PLLC)

In states where professionals are not allowed to structure their businesses as an LLC, licensed professionals can form a PLLC. A PLLC is a particular form of LLC designed for licensed professionals, such as accountants.

In general, the PLLC is a specific designation requiring all members rendering professional services to be licensed. The rules for LLCs and PLLCs vary by state, so you need to check with the Secretary of State office in the state where your business is located to find out what is allowed. For instance, in California, professionals are not allowed to form LLCs or PLLCS. California allows professionals to form registered limited liability partnerships (RLLPs) or professional corporations (PCs). More on that later. Professionals in New York can form a PLLC, but not an LLC.

As you probably guessed, the process and requirements to form a PLLC is more complicated than forming an LLC. As in a regular LLC, you need to create documents outlining how your PLLC will be structured and organized. These documents are called Articles of Organization and for a PLLC you need to have the state licensing board approve them before you file formation paperwork with the state. Articles of Organization and any other required formation paperwork can be filed directly through the Secretary of State's office, or you can have an online legal filing service handle all the filing.

As with the LLC, the PLLC establishes a separation between the business members and the business itself, however, there is an important difference. Professional members in a PLLC are personally liable for malpractice claims related to their own actions. Unlike in a partnership, where the liability would belong to all partners in the business, no matter who is being sued for malpractice, in a PLLC, the members are not liable for the malpractice of any other member of the PLLC. In any case, it's important for each member of the PLLC to have a good malpractice insurance policy.

As stated above, although California does not allow professionals to form an LLC or a PLLC, it does allow for the creation of a Registered Limited Liability Partnership (RLLP) or a Limited Liability Partnership (LLP). The designation is similar to PLLCs

in other states, however, is only open to California law firms and public accounting firms.

Similar to a PLLC, an individual partner of an LLP, is not legally responsible for the liability of any other partner and are not responsible for the business debts of the LLP.

C Corp

The Tax Cut and Jobs Act (TCJA) of 2017 gave C Corps a flat 21% tax rate. That combined with liability protection make the C Corp a good entity choice for accounting firms, if your state allows professionals to incorporate as a C Corp.

A C Corp's shareholders' personal liability is limited to the amount they have individually invested in the company. Once your accounting firm is incorporated, it exists as a separate business entity. Incorporating also boosts the credibility of your business and allows you to protect your business name and brand at the state level.

The only real downside of incorporating is you need to operate your business at a higher administrative level than you're used to as a sole proprietorship, partnership, or LLC. You'll need to form a board of directors, have regular shareholder meetings and stay in compliance with your state's requirements.

As with the LLC, if your state does not allow professionals to form a C Corp. In that case, you may be able to form a Professional Corporation.

Professional Corporation (PC)

Some states offer professionals the option to set up a Professional Corporation (PC), and California is one of them. A PC is a corporation designated specifically for licensed professionals and follows the same process as incorporating.

Like the PLLC, the formation documents must be first approved by the state licensing board before filing with the Secretary of State. In a corporation these are called Articles of Incorporation. The PC also protects owners from any personal liability associated with the business's debts and other owners' malpractice suits, but it does not protect against malpractice suits associated directly with your own work.

As in a corporation, the PC requires more administrative requirements than a PLLC. The owners must create a formal structure comprised of shareholders, officers, and

directors. There must be annual shareholder meetings and the board must keep minutes of the meetings.

The S Corp Election

As an LLC or C Corp, your accounting firm has the option of electing to be taxed as a Sub-Chapter S Corporation or S Corp. Although the S Corp is formed in the same manner as a C Corp, the corporate entity makes an election with the IRS to be taxed as a "pass-through entity" under subchapter S of the Internal Revenue Code. Therefore, the business is not a separate taxable entity; the profits and losses are "passed-through" and reported on the personal income tax returns of the shareholders, much like a partnership. The S Corp maintains the corporate liability protection.

Tax Considerations

As you well know, the LLC is a pass-through entity, with all business income passing through to members and reported on their personal tax returns. The same is true of the PLLC. In an LLC and PLLC, members can also elect to be taxed as a C Corp or an S Corp.

The PC, like the regular corporation, is taxed as a separate entity which leads to double taxation for shareholders. However, a PC (and regular C Corp) also has the capability to elect S Corp status to avoid double taxation.

Before deciding how to structure your accounting firm, talk to your attorney (or an incorporation expert) and research how other accounting firms in your state choose their business entity.

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Nellie Akalp is a passionate entrepreneur, business expert and mother of four. She is the CEO of CorpNet.com, a trusted resource and service provider for business incorporation, LLC filings, and corporate compliance services in all 50 states. Nellie and her team recently launched a partner program for accountants, lawyers, and business professionals to help them streamline the business incorporation and compliance process for their clients.

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