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PRIMER ON CHOICE OF LEGAL ENTITIES FOR PROFESSIONAL MEDICAL PRACTICES/ ANCILLARY MEDICAL VENTURES

by
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INTRODUCTION. As a result of relatively recent Florida legislative developments, including the adoption in recent years of uniform model acts and refinements in Florida income tax laws and rules applicable to state law legal entities and/or their owners, an increased number of legal entities are now available under Florida law for the operation of professional medical practices and ancillary medical ventures including diagnostic imaging centers, radiation therapy facilities, freestanding cardiac catheterization laboratories, comprehensive outpatient rehabilitation facilities and kidney dialysis facilities. The purpose of this Article is to both describe the various legal entities which can be selected under state law for the operation of professional medical practices and/or ancillary medical ventures and the federal and state income tax status which the owners thereof may cause such legal entities to elect, and to discuss certain key Florida laws, rules or regulations tax and non-tax and federal income tax and health laws or rules which impact such choice and income tax election in an effort to assist those desiring to participate therein, and their legal counsel, who may not otherwise be knowledgeable in the full range of Florida and federal laws relevant thereto, in selecting the most appropriate legal entity, having the most suitable federal and state income tax status, for their specific healthcare business or venture.

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1. ENTITY CHOICES/TAX STATUS.

I. **Professional Medical Practices.** Subject to satisfying applicable eligibility requirements or conditions, if any, the various legal entities which may be created under Florida law for the operation of professional medical practices, including physician, dental, podiatry or chiropractic practices, are as follows:

A. professional corporations (“PAs” or a “PA”) organized pursuant to Chapters 607 and 621, Florida Statutes;¹

B. professional limited liability companies (“PLLCs” or a “PLLC”) organized pursuant to Chapters 608 and 621, Florida Statutes;¹

C. for the medical professions (including physician and chiropractor practices) not subject to the prohibition on the corporate practice of medicine:² (1) for-profit (regular) corporations organized pursuant to Chapter 607, Florida Statutes, and (2) (regular) limited liability companies (“LLCs”) organized pursuant to Chapter 608, Florida Statutes;³ and

D. for professional medical practices having two or more equity owners, except as noted below: (1) general partnerships (“GP”), including “limited liability partnerships” (“LLPs”), organized pursuant to the Florida Revised Uniform Partnership Act of 1995, Sections,

¹See Section 2.II of this Article. As discussed therein, PAs and PLLCs can only be formed if all shareholders or members thereof are either individuals or other PAs or PLLCs legally licensed or authorized to provide the same professional services for which the PAs or PLLCs are organized. As a result of this rule, two or more separately licensed medical professionals, for example, chiropractors and physicians, could not jointly organize and own a PA or PLLC to provide physician and/or chiropractic professional services. However, duly licensed Florida physicians could organize and own a PA or PLLC which furnishes both professional physician and chiropractic services, so long as such physicians are permitted to render professional chiropractic services under their state physician licenses. Note, this limitation would not preclude two or more duly licensed Florida physicians (specializing in different practice areas) from owning and operating a “multi-specialty” physician medical practice through a PA or PLLC, since all such shareholders or members would be licensed to provide professional “physician” services.

²Most medical professionals, like lawyers, are or have been subject to a prohibition on the corporate practice of their profession. Under the initial enactment in Florida of the Professional Services Corporation Act, Chapter 621, Florida Statutes (the “Professional Services Act”), in 1961 and its subsequent amendment in 1993 (to include professional limited liability companies), licensed medical professionals subject to the “corporate practice of medicine doctrine” are prohibited from furnishing their professional medical services through or on behalf of any corporation (or other legal entity), other than a professional corporation or professional limited liability company meeting the requirements of the Professional Services Act. Since 1987, when the Florida Board of Medicine (“FBOM”) first ruled that duly licensed Florida physicians could practice medicine as employees of regular corporations (so long as licensed physicians maintain control over all clinical aspects of their practice of medicine), licensed Florida physicians have not been subject to the prohibition on the corporate practice of medicine. (See “In Re: The Petition for Declaratory Statement of John W. Lister, M.D., Petition, Case No. 87-DS-08, dated 12/3/87”.) Since the date of this 1987 declaratory statement, the FBOM has expanded its holding to allow Florida physicians to provide their professional medical services through or on behalf of any validly formed state law entity, including limited liability companies and limited partnerships.

³ While it is legally permissible for not-for-profit Florida corporations organized pursuant to Chapters 607 and 617, Florida Statutes, to own and operate professional physician medical practices and other professional medical practices not subject to a prohibition on the corporate practice of medicine, a discussion on the use of not-for-profit corporations and applicable federal and Florida laws and rules, including relevant income tax rules is beyond the scope of this Article.

620.81001 through 620.9902, Florida Statutes (“FRUPA”), and (2) limited partnerships (“LPs”) [including “limited liability limited partnerships” (“LLLPs”)], organized under the Florida Revised Uniform Limited Partnership Act of 2005 (“RE:RULPA”), Chapter 620, Florida Statutes.⁴

Notwithstanding the foregoing, medical professionals subject to a prohibition on the corporate practice of medicine are legally precluded from operating their professional medical practices through LPs (or LLLPs) and can only do so through GPs (or LLPs) if all partners thereof are either duly licensed individuals or PAs or PLLCs legally authorized to render the same professional medical services as the GPs are organized to provide.

II. **Ancillary Medical Ventures.** The state law legal entities available for the operation of ancillary medical ventures (including ancillary medical ventures to be owned by duly licensed medical professionals, but which may not be operated as part of their professional medical practices), including diagnostic imaging centers, radiation therapy facilities, freestanding cardiac catheterization laboratories, kidney dialysis centers and comprehensive outpatient rehabilitation facilities, include each of the above-described legal entities otherwise available for the operation of professional medical practices, other than, with very limited exceptions, PAs or PLLCs.⁵

III. **Available Tax Status.** The above-described respective legal entities which may be organized under Florida law to own and operate professional medical practices or ancillary medical ventures may elect [subject to satisfying applicable eligibility requirements otherwise imposed by the Internal Revenue Code of 1986, as amended (the “Code”)] one of the following statuses for federal (and state) income tax purposes.⁶

⁴RE:RULPA is effective January 1, 2006, for limited partnerships formed on or after such date and is effective for limited partnerships in existence before January 1, 2006 as of January 1, 2007 (unless they elect an earlier effective date). Given the provisions of RE:RULPA, and the benefits of “LLLP” status to an LP’s general partners, this Author expects that most LPs formed on and after January 1, 2006, for the purpose of owning and operating any trade or business, will be organized as “LLLPs”. See discussion in Section 2.I.D(1) of this Article.

⁵Because PAs and PLLCs, by statute, may only include corporations or limited liability companies organized for the sole and specific (primary) purpose of rendering “professional services” of a type which require, as a condition precedent to rendering such professional services, the obtaining of a license or other legal authorization, ancillary medical ventures principally formed to offer the technical component of medical services cannot qualify for PA or PLLC status, even if all shareholders or members thereof are duly licensed Florida medical professionals legally authorized to offer such ancillary (technical) medical services as part of their professional medical practices. Exceptions to the general rule that PAs or PLLCs are not available for the operation of ancillary medical ventures may include the operation of diagnostic imaging facilities by duly licensed Florida radiologists who offer the technical component of diagnostic imaging services through a PA or PLLC, as part of and ancillary to their provision of their professional interpretative services. See Sections 621.03(2) and (3) and 621.05, Florida Statutes.

⁶The election of income tax status is generally made upon entity formation, by the filing of a Form SS-4 (request for “Employer Identification Number) with the Internal Revenue Service (the “Service”), although, subject to satisfying certain applicable eligibility and timing rules and requirements, a legal entity may subsequently elect to change its tax status. However, because a subsequent change in a legal entity’s tax status may trigger immediate and/or future adverse income tax consequences to the applicable legal entity or its owners under applicable provisions of the Code, taxpayers/owners should seek to elect the desired income tax status for their respective legal entities upon entity formation.

A. PAs/Regular Corporations. PAs or regular corporations may elect to be treated and taxed as either regular “C corps” (subject to the rules of Subchapter C of the Code) or (if they satisfy all eligibility requirements), as “S corps”, subject to the rules of Subchapter S and Subchapter C, as modified by the rules of Subchapter S, of the Code. Neither PAs nor regular corporations can elect to be treated as “partnerships” for federal or state income tax purposes.

B. LLCs (PLLCs), GPs (LLPs) and LPs (LLLPs). LLCs (including PLLCs), GPs (including LLPs) and LPs (including LLLPs) may elect to be treated as either “partnerships”, subject to Subchapter K of the Code (“tax partnerships”)⁷ or as “associations”, taxable as C corps or, if they satisfy all eligibility requirements, S corps;⁸ provided, that, LLCs (including PLLCs) having only one member may not elect tax partnership status. [Single member LLCs, generally, are automatically taxed as “disregarded entities” for federal (and state) income tax purposes unless an affirmative election to be taxed as a C corp or S corp is made.]⁹

2. CHOICE OF ENTITY: NON-TAX CONSIDERATIONS. The following discusses certain material non-tax Florida laws or rules (and federal healthcare laws) and considerations thereunder, which impact the choice of a legal entity for the operation of professional medical practices and/or ancillary medical ventures.

I. State Law Regulatory Features/Comparative Analysis.

A. General Regulatory Regime/Consequences Thereof. The Florida Business Corporation Act, Chapter 607, Florida Statutes, sets forth a body of rules which govern and regulate Florida corporations and address the respective rights, responsibilities and obligations of their officers, directors and shareholders (both as to internal corporate matters and in their relations with certain third parties).¹⁰ There is a “wealth” of case law interpreting the Florida Business Corporation Act (both within and outside Florida). Contrary to the Florida Business Corporation Act, the regulatory regime for LLCs, GPs and LPs generally consist of a series of default rules (which for the most part are not subject to extensive interpretation under case law), patterned after relatively recently enacted uniform model acts, which, in the absence of contrary

⁷Similar to the requirements for forming a “partnership” (GP or LP) under state law, in order to elect “tax partnership” status for federal (and state) income tax purposes, an LLC (including PLLC), GP (including LLP) or LP (including LLLP) must have two or more members or partners recognized as separate persons under federal income tax laws.

⁸Notwithstanding the ability of LLCs, GPs and LPs to elect to be taxed as C corps or, if otherwise eligible S corps, persons usually form LLCs, GPs (including LLPs) and LPs (including LLLPs) because of their desire to operate their businesses through “tax partnership” vehicles. With the relatively recent adoption of a model uniform limited liability company act which generally precludes judgment creditors of members from foreclosing on debtor-members’ membership interests [see discussion in Section 2.I.D(2) of this Article], some practitioners have recommended that medical professionals otherwise seeking to operate professional medical practices through a legal entity taxed as an S corp for federal (and state) income tax purposes, use an LLC, which elects “S” corp status, for such purpose, rather than a corporation, so as to obtain the “asset protection” benefits arising from such limitation on judgment creditor rights. See discussions in Sections 2.I.A and D of this Article.

⁹A state law partnership which has only one person recognized as a partner for federal income tax purposes and which does not otherwise elect C corp or S corp status, will also be treated as a “disregarded entity” for federal income tax purposes.

¹⁰Notwithstanding the normal statutory scheme, shareholders of non-publicly traded corporations having no more than 100 shareholders can cause their corporations to adopt contrary rules. See Section 607.0732, Florida Statutes.

provisions of an operating or partnership agreement entered into the members or partners thereof, govern the respective rights, responsibilities and obligations of their members or partners. Because of the nature and content of these “default rules”, most attorneys, including this Author, strongly recommend that persons entering into LLCs, GPs or LPs (other than single member LLCs) negotiate and enter into reasonably detailed and comprehensive operating or partnership agreements that adequately address day-to-day business matters, including the respective members’ or partners’ rights to participate in the management or operation of the respective legal entity’s business and affairs, as well as the respective rights and interests of the members or partners in and to the profits, losses and capital thereof, restrictions on the transferability of equity interests therein and any reasonably foreseeable future events, the occurrence of which are likely to have material adverse impact on either the LLC, GP or LP and/or certain or all of the members or partners thereof, to ensure that member or partner rights and obligations are as the parties intend and to avoid or minimize any future disagreements or misunderstandings which may otherwise arise in the absence of addressing the same in such an agreement.¹¹

Principally as a result of these differences in regulatory regimes, and the actual or potential adverse consequences arising therefrom (including increased organizational costs resulting from the need to negotiate and prepare a suitably detailed and comprehensive operating or partnership agreement, and/or the actual or potential costs of future litigation resulting from the failure to address or adequately address, in an operating or partnership agreement to which all members or partners are parties, matters which can adversely impact the venture or its participants and which are either not addressed or addressed in a manner acceptable to the participants under state law), this Author would generally recommend using a corporation organized under state law, electing S corp status, rather than using an LLC (or GP or LP) that elects S corp (or “tax partnership”) status, to operate most professional medical practices. Of course, there may be instances where the benefits of utilizing a legal entity treated as a tax partnership for federal (and state) income tax purposes outweigh the net benefits of using a corporation electing S corp status for such purposes [or other “net”, non-tax benefits of using an LLC (or GP or LP), rather than a corporation, including a PA, outweigh the actual and/or potential adverse economic consequences arising from the differences in state regulatory regimes].¹²

¹¹While shareholders of regular Florida corporations having no more than 100 shareholders are permitted to enter into shareholders agreements which can include provisions effectively converting their corporations into partnerships, in the usual course of operating professional medical practices or ancillary medical ventures through a corporation, the shareholders typically would not seek to adopt such contrary rules. Rather, shareholders of closely held corporations engaged in the operation of any trade or business, including professional medical practices or ancillary medical ventures, are generally advised to negotiate and enter into a “stock restriction and shareholders agreement”, principally for the purpose of evidencing restrictions on transferability of such corporation’s stock. Because the typical stock restriction and shareholders agreement is substantially less extensive than the typical operating or partnership agreement corporate shareholders agreements are generally substantially less expensive to negotiate and prepare than the typical recommended operating or partnership agreements.

¹²One perceived or actual benefit of utilizing an LLC (or GP or LP) over a corporation is the statutory rule which precludes judgment creditors of members (or partners) from foreclosing (levying and executing) on a debtor-member’s (or debtor-partner’s) membership (or partnership) interest. See discussion in Section 2.I.D(2) of this Article. While statutory limits on who may own stock in a professional corporation (see discussion in Section 2.II of this Article) would suggest a non-licensed judgment creditor of a shareholder of a professional corporation would be legally unable to foreclose on such shareholder’s stock therein, the Florida Supreme Court, in Street v. Sugarman, 202 So. 2d 749 (Fla. 1967), held that such statutory limits do not exempt shareholders of PAs from levy and sale,

B. Management Rights-Restrictions/Power to Bind. Under applicable Florida law, shareholders of regular corporations (including PAs), members of LLCs (including PLLCs) and partners or general partners of GPs or LPs, each have the right to participate (directly or indirectly) in the management of the business and activities of their respective corporations, LLCs, GPs or LPs, either directly or through their right to elect the respective legal entity's directors, managing partners or managing members or managers unless waived under the terms of a shareholders, operating or partnership agreement entered into by the shareholders, members or partners thereof.¹³ Conversely, limited partners of Florida LPs have no right to participate in the management of the business or affairs of LPs, unless such right is expressly granted under the terms of an applicable limited partnership agreement to which all partners (general and limited) are parties.¹⁴

Each member of a member-managed LLC, each partner of a GP and each general partner of an LP has the apparent authority to act on behalf of the LLC, GP or LP, as the case may be, in the ordinary course of its business, and, accordingly, any such member or partner can legally bind the LLC, GP or PA for acts taken in the ordinary course of the LLC's, GP's or LP's business (even if acting without authority), unless the member or partner has no actual authority to act on behalf of the LLC, GP or LP and the person with whom the member or partner was dealing knew or had reason to know that such member or partner lacked actual authority.¹⁵ Conversely, neither shareholders of corporations, members of manager-managed LLCs nor limited partners of LPs, in their capacities as such, have either actual or apparent authority to act on behalf of or otherwise to bind their corporations, LLC or LPs to any matter, even if in the ordinary course of any such legal entity's business.

under execution, by a judgment creditor, even if the judgment creditor (or other purchaser) is not licensed to provide the same professional services as the PA was organized to provide.

¹³Unless varied by the terms of a shareholders agreement entered into by all shareholders, by statute, Florida corporations (including PAs) are managed by their board of directors and their shareholders, by majority vote, may elect and remove and/or replace the members of a corporation's board of directors annually (or at any other time). Similarly, unless waived by the terms of an operating agreement to which all members are parties by statute, members of a Florida LLC each have the right to participate in management, either directly as a managing member or, if manager-managed, through the right to vote (and/or remove and replace) the LLC's managers; and each partner in a GP and all general partners of LPs, have the statutory right, unless waived by the terms of an applicable partnership agreement, to participate in the management of the GP or LP. See Sections 607.0728 (corporations), 608.422 (LLCs), 620.8401(6) (GPs) and 620.1406 (LPs), Florida Statutes.

¹⁴Under RE:RULPA, an LP's limited partnership agreement can expressly grant any limited partner management authority and control over any aspect of the LP's business or affairs without such grant of management authority causing the designated limited partner to assume "personal liability" as a "general partner". See Section 620.1303, Florida Statutes. Under prior Florida limited partnership law (in effect up until January 1, 2007 at the latest for LPs formed before 2006), any limited partner participating in the management of the business of a Florida LP would be treated as a "general partner" thereof and, in such status, would become personally liable, jointly and severally, for all outstanding liabilities and obligations of the LP incurred while such limited partner is deemed to be a general partner.

¹⁵See Sections 608.4235 (LLCs), 620.8301(1) (GPs) and 620.1402 (LPs), Florida Statutes.

C. Continuity of Life/Right to Dissolve. Under applicable Florida law¹⁶ corporations and, unless otherwise specified in their respective operating or limited partnership agreements, LLCs and LPs (but not GPs) exist in perpetuity and, except as may be expressly granted by the terms of an applicable shareholders, operating or limited partnership agreement to which all shareholders, members or partners are parties, no shareholder, member or partner thereof has the unilateral right or power to dissolve or terminate any such legal entity.¹⁷

Unless otherwise provided in a shareholders, operating or partnership agreement to which all shareholders, members or partners are parties, under state law, neither shareholders of corporations (including PAs), members of LLCs (including PLLCs) nor limited partners of LPs have the right to withdraw from their respective corporation, LLC or LP or otherwise force, by unilateral action, a mandatory purchase of their respective interests therein. Similarly, while general partners of LPs subject to RE:RULPA have the right to “dissociate” (or withdraw) from their LP as a “general partner” at any time, even if prohibited by the terms of the applicable limited partnership agreement, such dissociation does not entitle the dissociated general partner to any distributions nor will such dissociation cause or result in a dissolution of the LP unless expressly required by the applicable limited partnership agreement or unless the dissociated general partner was the sole general partner of the LP and within 90 days from the date of dissociation, all remaining limited partners do not otherwise agree to continue the business of the LP or agree to admit and cause to be admitted at least one additional general partner. By contrast, general partners of LPs not subject to RE:RULPA, are entitled by statute to be paid the “fair market value” of their interest in such LPs upon their dissociation or withdrawal therefrom, if not otherwise provided by the terms of their applicable limited partnership agreement, even if they dissociate or withdraw from their LP in violation of the terms of their LP’s limited partnership agreement.¹⁸

¹⁶All LPs formed before 2006, under the Florida limited partnership law then in effect, were required to specify an outside date upon which the LPs would dissolve in their initial filed certificates of limited partnerships, as a condition to their formation. In contrast, under RE:RULPA, unless otherwise provided to the contrary in a limited partnership agreement to which all partners are parties, Florida LPs exist in perpetuity.

¹⁷Notwithstanding the perpetual existence of LLCs and LPs, an LLC will dissolve at such a time as it has no remaining members (whether resulting from the death of the theretofore sole or last member or otherwise) unless the personal or other legal representative of the last remaining member agrees in writing to continue the LLC and to the admission of the personal representative of such member or its nominee or designee as a member of the LLC within ninety (90) days from the date that there shall otherwise be no remaining member (or within such other period, if any, provided in the LLC’s articles of organization or operating agreement). An LP will dissolve following: (i) the “dissociation” (or withdrawal) of the last remaining limited partner unless within 90 days following such dissociation (or withdrawal), the LP admits at least one additional limited partner; or (ii) the “dissociation” (or withdrawal) of its sole or last remaining general partner unless within 90 days following such dissociation (or withdrawal), all partners agree to continue the activities of the LP and to admit at least one general partner and at least one person is admitted as a general partner in accordance with such consent within said 90 day period. Further, both LPs and LLCs will dissolve upon the happening of any event specified in their respective limited partnership or operating agreement. See Section 608.441, Florida Statutes (re: dissolution of LLCs) and Section 620.1801, Florida Statutes (re: non-judicial dissolution of LPs).

¹⁸Under Florida limited partnership law in effect prior to RE:RULPA, LPs automatically dissolve upon the withdrawal of any general partner unless there remains at least one general partner who continues the business of the limited partnership under a right to do so granted by such LP’s limited partnership agreement or unless, within 90 days from the date of withdrawal, all remaining partners agree to continue the business of such LP and to the appointment of one or more additional general partners, as necessary or desirable.

Contrary to the perpetual existence and continuity of life of Florida corporations, LLCs and LPs, and contrary to the lack of withdrawal/dissolution rights of shareholders, members or partners of Florida corporations, LLC and LPs, under FRUPA, any partner of a GP (or LLP) can dissociate from the GP (or LLP) at any time [even if such withdrawal violates the terms of the GP's (or LLP's) partnership agreement] and, in connection therewith, either force a dissolution of the GP (or LLP) or an immediate mandatory purchase of the withdrawing partner's interest therein, generally for its fair market value (as calculated without regard to the services of the withdrawing partner).¹⁹ It is the effective lack of continuity life of a GP (including LLPs) resulting from the above-described statutory right of a partner of a GP to dissociate at any time, and the resulting obligation of a GP to dissolve or to purchase a withdrawn partner's interest in the GP for its fair value which causes GPs not to be favored vehicles for the operation of most professional medical practices or ancillary medical ventures. However, the same statutory right of dissociation can also make a GP the vehicle of choice for those equity participants who otherwise desire a unilateral right of withdrawal so as to be able to force either a dissolution of the venture or a mandatory purchase of their venture interest at such time as they may otherwise determine.

D. Owner Liability/Asset Protection.

(1) Owner Liability. Under Florida law, unless organized as an LLP or LLLP, each partner of a GP and each general partner of an LP, is personally (jointly and severally) liable for all of the debts and liabilities of the GP or LP, including contractual liabilities and tort liabilities. However, if a GP elects LLP status or an LP elects LLLP status, then none of the partners or general partners of the LLP or LLLP will have any personal liability for any debts or liabilities of the LLP or LLLP incurred while an LLP or LLLP (unless they contractually agree to assume personal liability, for example, by signing a personal guarantee).²⁰

¹⁹See Sections 620.8601, 620.8701 and 620.8801, Florida Statutes. Except as noted below, under FRUPA, a partner dissociating from a GP, even if in violation of the terms of the GP's partnership agreement, will generally be entitled to payment of the full value of withdrawn partner's GP interest within 120 days from the date of dissociation, unless the GP dissolves as a result of such dissociation or unless different payment rules are provided in the GP's partnership agreement. However, under FRUPA, if a general partner dissociates from a GP which is organized for a definite term or for the completion of a particular undertaking, in violation of the terms of such GP's partnership agreement, then such general partner will not be entitled to be paid for such general partner's interest in such GP (if such GP does not otherwise dissolve by reason of such general partner's dissociation), until the expiration of the stated term of such GP or until completion of such GP's specified undertaking unless a different payment rule is provided in such GP's partnership agreement. In such event, interest will or may have to be paid on the deferred purchase price and the deferred payment obligation will or may be required to be secured. See Section 620.8701, Florida Statutes.

²⁰One would expect that any GP or LP formed to operate any trade or business, including a professional medical practice or ancillary medical venture, would elect LLP or LLLP status so that the partners or general partners thereof do not have personal liability in their respective capacities as "general partners" for the debts and obligations of the LLP or LLLP. One possible exception to electing LLP or LLLP status is as follows:

A partner's basis in a tax partnership is important in determining the total amount of partnership losses which a partner may be allocated and can deduct on their personal income tax return and/or the total cash distributions which a partner may receive without incurring any tax liability. As further discussed in Section 3.III.A(5) of this Article under Tax Considerations--a partner's basis in a tax partnership is determined, in part, by a partner's allocable share

Contrary thereto, under Florida law, neither shareholders of Florida corporations (including PAs), members of Florida LLCs (including PLLCs), nor limited partners of Florida LPs have any personal liability for any of the debts or obligations of their corporation, LLC or LP, in their respective capacities as “shareholders”, “members” or “limited partners” thereof.²¹

(2) Claims of Outside Creditors. Unlike judgment creditors of shareholders of corporations (including PAs), who are generally able to foreclose on a debtor-shareholder’s stock in a Florida corporation in order to satisfy their judgments, judgment creditors of members of LLCs or partners (general or limited) of GPs or LPs are precluded from foreclosing on a debtor-member’s or debtor-partner’s equity interest and, instead, are limited to obtaining what is known as a “charging order” against the debtor-member’s or debtor-partner’s respective membership or partnership interest.²² If a judgment creditor of a member or partner obtains a charging order against the debtor-member’s or debtor-partner’s membership or partnership interest, then such creditor will only be entitled to receive whatever distributions, if any, the debtor-member or debtor-partner is otherwise entitled to receive from the LLC, GP or LP, at the time or times the debtor-member or debtor-partner would otherwise be entitled thereto, until such time such creditor’s judgment (secured by such charging order) is satisfied in full.²³

E. State Filing Fees. As of 2006, the initial and annual filing fees for Florida corporations (including PAs), LLCs (including PLLCs), GPs (including LLPs) and LPs (including LLLPs) are as follows:

of the tax partnership’s outstanding indebtedness. For this purpose, partnership indebtedness for which no partner has personal liability is generally allocated among all partners based on their respective interests in partnership profits, while partnership liabilities for which one or more partners have personal liability, are generally allocated only among those partners having such personal liability, generally, in proportion to their relative interests in partnership losses. Because electing LLP or LLLP status will or may result in the partners or general partners thereof not having personal liability for partnership indebtedness, such election will or may alter the manner in which the LLP’s or LLLP’s indebtedness is allocated among its partners for purposes of calculating the partners’ basis therein. Those partners whose basis (i.e., share of the partnership indebtedness) would be adversely affected by reason of electing LLP or LLLP status may not want their partnership to elect such status.

²¹Notwithstanding the limits on personal liability of shareholders or members in their respective capacities as “shareholders” or “members”, shareholders or members, in their capacities as officers, agents, members, managers or employees of a corporation or LLC, will or may be personally liable for their own negligence or wrongful acts or misconduct. Further, officers, agents, members, managers or employees of PAs or PLLCs providing professional medical services for or on behalf of their PA or PLLC will be personally liable for their own negligent or wrongful acts as well as for the negligent or wrongful acts or misconduct committed by those medical professionals who work under their direct supervision and control. See Section 621.07, Florida Statutes.

²²See Sections 608.433(4) (LLCs), 620.8504 (GPs) and 620.1703 (LPs), Florida Statutes.

²³Unlike the statutory rule applicable to judgment creditors of partners of a GP or LP, the statutory rule limiting judgment creditors of a member of an LLC to obtaining a charging order against the debtor-member’s LLC interest is not expressly specified to be such creditor’s exclusive remedy and, based on case law in other states (and the purposes behind the legal development of the “charging order” rule, i.e., to prevent creditors of individual partners or members from adversely impacting the rights and interests of the non-debtor partners or members in and to the business and assets of the applicable partnership or LLC), members of “single member LLCs” should anticipate that this statutory rule will likely not apply to their judgment creditors.

Corporations:	\$35.00 initial filing Articles of Incorporation plus \$35.00 for designating initial registered agent. \$61.25 plus \$88.75 (supplemental corporate fee) (total \$150.00) for each annual report.
LLCs (PLLCs):	\$100.00 initial filing Articles of Organization, plus \$25.00 designation initial registered agent. \$50.00 for each annual report.
LPs (LLLPs):	\$965.00 initial filing Certificate of Limited Partnership, plus \$35.00 appointing initial registered agent (total \$1,000.00). \$411.25, plus \$88.75 (supplemental corporate fee) (total \$500.00) for each annual report.
GPs:	Not required to file any initial or annual documents unless the GP voluntarily registers (registration is required for, among other purposes, to adopt LLP status).
Registered GPs (including all LLPs):	\$50.00 initial filing partnership registration statement. \$25.00 initial filing Statement of Qualification (LLP). \$25.00, for each annual report.

II. Professional Corporations/Professional Limited Liability Companies: Conditions and Limits. The Professional Services Act was initially enacted in 1961 to allow duly licensed professionals, including medical professionals, who were otherwise prohibited from practicing their profession through a corporate vehicle, to provide their professional services through a corporate entity.²⁴

A. Formation Requirements. A corporation or LLC otherwise organized under Chapter 607 or Chapter 608, Florida Statutes, can qualify as a PA or PLLC under Chapter 621, Florida Statutes, if (and only if) it: (i) is organized for the sole and specific purpose of rendering professional services to the public of a type which requires, as a condition precedent to the rendering thereof, the obtaining of a license or other legal authorization; and (ii) has as shareholders or members, only other PAs, PLLCs or individuals who themselves are duly licensed or otherwise legally authorized to render the same professional services for which the

²⁴The Professional Services Act was later amended in 1993 to allow the use of professional limited liability companies.

corporation or LLC was organized.²⁵

B. Permitted Shareholder-Members/Formation Requirements. Under the Professional Services Act, a PA or PLLC, and their shareholders or members, may only (voluntary) issue or transfer stock or membership interests in the PA or PLLC to another PA or PLLC or to individuals duly licensed or otherwise legally authorized to render the same professional services as those for which the PA or PLLC was organized to provide.²⁶ Further, shareholders and/or members of PAs or PLLCs are precluded from entering into any voting trust agreement or any other type of agreement which vests in any person not otherwise qualified to be a shareholder or member of the PA or PLLC any authority to exercise any voting power that such shareholder or member may have for or with respect to the PA or PLLC.²⁷

C. Permitted Directors-Officers/Managers. Persons who may serve as officers and directors of PAs are limited solely to individuals duly licensed to provide the same professional services as those for which the PA was organized. Managers of PLLCs (with regard to manager-managed PLLCs) must either be duly licensed individuals or other PAs or PLLCs legally authorized to furnish the same professional services as the PLLC.²⁸

D. Limitation on Business Activities/Permitted Ancillary Activities. PAs and PLLCs generally are precluded under the Professional Services Act from engaging in any business other than the rendering of the professional services for which they are specifically organized.²⁹ Such rule, however, expressly does not preclude PAs and PLLCs from owning real or personal property if necessary for the rendering of their professional services. Further, based on custom and usage (and lack of regulatory action to date), PAs or PLLCs engaged in the operation of professional medical practices are generally permitted to furnish technical medical services (for example, diagnostic imaging services, including x-rays, clinical lab services, etc.) and otherwise sell their patients medical goods and products, including, if properly registered or licensed, pharmaceuticals, if such goods or activities are provided or performed ancillary to the provision of the specific professional medical services for which the PA or PLLC is organized to provide, to assist in the evaluation and/or treatment of their patients.

²⁵See Sections 621.03(2), 621.03(3), 621.05 and 621.051, Florida Statutes. Corporations or LLCs desiring to qualify as PAs or PLLCs generally must include appropriate limiting language in their Articles of Incorporation and/or Bylaws as to their business purpose and as to who may be or become its shareholders, members, officers, directors and/or managers.

²⁶ Notwithstanding this statutory rule, the Florida Supreme Court has ruled that such statutory limits do not exempt shares of stock in a PA from levy and sale, under execution, as a result of a judgment against a shareholder of a PA by a non-professional judgment creditor. See Street v. Sugarman, 202 So. 2nd 749 (Fla. 1967). If any such sale should occur and PA stock ends up in the hands of a non-licensed individual, then, unless such shares of stock are purchased, redeemed or otherwise acquired by the PA or a duly licensed individual, as otherwise required by Section 621.10, Florida Statutes, the acquisition and ownership of PA stock by a non-qualified judgment creditor constitutes grounds (under Section 621.10, Florida Statutes) for forfeiture of the PA's articles of incorporation and its dissolution. See Street v. Sugarman, Id.

²⁷See Sections 621.09 and 621.11, Florida Statutes.

²⁸See Section 621.06, Florida Statutes, and Attorney General Opinion 061-139 (September 12, 1961).

²⁹See 621.08, Florida Statutes.

E. Availability of Both Regular and Professional Corporations/Limited Liability Companies and PLLCs. While the Professional Services Act was enacted to enable professionals otherwise subject to the prohibition on the corporate practice of their profession to provide their professional services through a professional corporation or professional limited liability company, licensed medical professionals not subject to the prohibition on the corporate practice of medicine (for example, licensed Florida physicians) may still organize a PA or PLLC to furnish their professional medical services if their corporation or limited liability company otherwise satisfies the requirements for being a PA or PLLC.³⁰

III. Florida/Federal Healthcare Laws. The following briefly discusses a Florida and federal health law and a federal (Medicare) rule which may impact the choice of legal entity to operate professional medical practices or ancillary medical ventures.

A. Florida/Federal Anti-Referral Laws. Under applicable Florida law,³¹ licensed Florida physicians (medical doctors and osteopaths), chiropractors, podiatrists, optometrists and dentists and under applicable federal law,³² licensed Florida physicians, are generally prohibited from referring³³ any patients to any legal entity, including their own professional medical practices, for the provision of any “designated health services” including diagnostic imaging, physical therapy, clinical laboratory and radiation therapy or, under Florida law, any other healthcare good or service (a “non-designated health service”) if either the referring healthcare provider or any of their immediate family members³⁴ own a direct or indirect investment interest in such legal entity unless such referral or such investment interest satisfies an enumerated statutory or regulatory exception.³⁵ If a prohibited referral for any medical service or good is made, the entity furnishing such services or goods is precluded from billing for such services or goods.³⁶

³⁰See Section 621.04, Florida Statutes. Because of this allowance and the potential asset “protection” benefits inuring to shareholders of PAs by reason of the statutory limits on who may acquire PA stock, when S corp status is possible and preferred (over tax partnership status) or where S corp and tax partnership status confer substantially equal benefits, this Author would generally always recommend that Florida licensed physicians, chiropractors and other medical professionals not subject to the prohibition on the corporate practice of medicine, still form professional corporations (PAs) (electing S status) to operate their professional medical practices.

³¹The Patient Self Referral Act of 1992, Section 456.053, et. sec. Florida Statutes.

³²42 USC § 1395nn.

³³For this purpose, a “referral” means any referral of a patient by a healthcare provider for healthcare services including, without limitation, the forwarding of a patient by a healthcare provider to any other healthcare provider or to any legal entity which provides or supplies any healthcare item or service or the request or establishment of a plan of care by a healthcare provider which includes the provision of any healthcare item or service.

³⁴Immediate family members include parents, spouses, children and grandchildren.

³⁵The prohibition on referrals under federal law only applies to “designated healthcare services”, as defined by “Stark II”, which are subject to reimbursement under Medicare or any state Medicaid program. In addition, the prohibition on patients referrals under federal law extends to referrals for designated health services to any legal entity with respect to which the referring physician or any immediate family member thereof has a direct or indirect compensation arrangement unless such compensation arrangement satisfies an enumerated exception.

³⁶A willful referral in violation of the Florida anti-referral law can result in disciplinary action by the Florida board or agency regulating the applicable healthcare provide. A willful violation by a licensed physician of the federal anti-referral law can result in the imposition of civil monetary penalties against such physician.

The enumerated exceptions allowing a physician (or other designated healthcare provider) to make an otherwise prohibited patient referral under both Florida and federal laws are generally divided into three categories: “provider specific”/“procedure specific” referrals, “generic provider”/“generic procedure” referrals, and “entity specific” referrals. The latter two classes of permitted referrals, unlike the “provider specific”/“procedure specific” referrals (which generally allow either specific providers to make an otherwise prohibited referral for specific or general medical services or allow any provider to make an otherwise prohibited referral for specific medical services, without limitation), generally only apply if the patient referral is made to a legal entity having some specified relationship with the referring healthcare provider or to a legal entity having specified types of owners and/or specific types of ownership interests.³⁷

Accordingly, if healthcare providers (as described above) otherwise subject to the Florida or federal anti-referral laws desire to refer patients to a professional medical practice or ancillary medical venture with respect to which they (or an immediate family member) will invest, directly or indirectly, then, unless either such healthcare providers and/or the specific medical services to which their referrals relate qualify for a provider specific/procedure specific referral exception, the legal entity formed or used to operate such medical practice or undertake such ancillary medical venture (and/or the equity interests in such legal entity or such legal entity’s relationship with the referring healthcare providers) will be required to satisfy the specific conditions of that generic provider/generic procedure (or entity specific) referral exception, if any, which may otherwise be available as a condition to allowing such referrals.³⁸

³⁷The “provider specific”/“procedure specific” exceptions to Florida law’s general prohibition on patient referrals are as follows: (i) by a radiologist for diagnostic imaging services; (ii) by a physician (radiation oncologist) specializing in the provision of radiation therapy services for such services; (iii) by a medical oncologist for drugs and solutions (chemotherapy) prepared and administered intravenously to such medical oncologist’s patients, (iv) by a cardiologist for cardiac catheterization services; (v) by a pathologist for diagnostic clinical laboratory tests and pathological examination services if furnished by or on behalf or under the supervision of such pathologist pursuant to a consultation requested by another physician; (vi) by any designated healthcare provider for services provided by an “ambulatory surgery center” licensed under Chapter 395, Florida Statutes; (vii) by a urologist for lithotripsy services; (viii) by a dentist for dental services performed by either a licensed healthcare provider who is employed or engaged as an employee or independent contractor of the referring dentist or the referring dentist’s group practice; (ix) by a physician for infusion therapy services to a patient of the physician or a member of that physician’s group practice; (x) by a nephrologist for renal dialysis services and supplies, except laboratory services; and (xi) by a healthcare provider whose principal professional practice consists of treating patients in their private residences, for any healthcare services to be rendered in such private residences (excluding services rendered by a home health agency licensed under Chapter 400, Florida Statutes). See Chapter 456.053(3)(o)3.a-3.e and 3.g - 3.l.

³⁸The only generic provider/generic procedure referral exception available under Florida law for referrals for designed health services (this exception also allows referrals for non-designated health services), allows healthcare providers who are solo practitioners or members of a “group practice” [within the meaning of Section 456.053(3)(h)] to refer patients to their solo or group medical practice for designated (or non-designated) health services; provided such services (i) are prescribed or provided by such solo or group practice solely to practice patients [as defined in Section 456.053(3)(n), Florida Statutes], and (ii) are provided or performed by or under the direct supervision [within the meaning of Section 456.053(3)(e), Florida Statutes] of the referring healthcare provider or, if a member of a group practice, by another duly licensed healthcare provider who is a member of his or her group practice; provided, that, duly licensed Florida physicians, chiropractors and podiatrists can refer patients to his or her solo practice or group practice for the provision of diagnostic imaging services, even if such solo or group practice furnishes diagnostic imaging services to non-patients, so long as not more than 15% of the persons receiving diagnostic imaging services from such practice during a given fiscal year (generally July 1st through June

B. Independent Diagnostic Testing Facilities. Under the Medicare program, the only persons permitted to bill for diagnostic imaging services rendered to Medicare beneficiaries are physician groups, hospitals and other persons who qualify and register with Medicare as “Independent Diagnostic Testing Facilities” (“IDTFs”). While a discussion of the rules applicable to IDTFs are beyond the scope of this Article, suffice to say that due to the additional administrative and supervisory duties and responsibilities imposed on IDTFs’ operation of diagnostic imaging facilities and the actual or potential considerable additional time, effort and expense resulting therefrom, medical professionals desiring to establish ancillary medical ventures or professional medical practices furnishing diagnostic imaging services, will or may want to use a legal entity to undertake the same which can qualify as a “physician group” under the Medicare program.³⁹

3. INCOME/OTHER TAX CONSIDERATIONS.

I. C Corporations vs. “Pass Through Entities” - Double Taxation vs. Single Taxation. The principal income tax difference between regular C corps, on one hand, and S corps and tax partnerships (“pass-through vehicles”), on the other hand, is that the net taxable income of C corps is subject to double tax (federal and state income taxes), once at the corporate level when earned and then at the shareholder level when distributed (as dividends). With one

30th) are non-patients of such practice, and such practice satisfies all of the additional conditions specified in Section 456.053(4), Florida Statutes.

In addition to the above, healthcare providers are allowed to refer patients for non-designated health services to a legal entity such healthcare providers or any immediate family members thereof has invested in, directly or indirectly, if: (i) such legal entity is either: (1) a public company (i.e., a corporation whose shares of stock are traded on a national exchange or on an over the counter market) having total assets, as determined from time to time at the end of the public company’s most recent fiscal quarter, exceeding \$50,000,000 [provided, as a condition to such referrals, the investment interests owned in the public company by the referring healthcare provider (or an immediate family member thereof) constitute “registered securities”], or (2) any other legal entity, all of the following conditions of which are satisfied: (a) no more than 50% of the value of its investment interests are held by investors who are in a position to make referrals to the legal entity, (b) the terms under which an investment interest is offered to investors who are in a position to make referrals to such entity are no different from the terms offered to other investors, (c) the terms under which an investment interest is offered to an investor who is in a position to make referrals to such entity are not related to the previous or expected volume of referrals from that investor to such entity, and (d) there is no requirement that an investor make referrals or be in a position to make referrals to such entity as a condition for becoming or remaining an investor; and (ii) the following additional conditions are satisfied: (x) neither such public company nor such other legal entity loan funds to or guarantee loans for any investor who is in a position to make referrals to such entity for the purpose of obtaining an investment interest therein, and (y) the amounts which such public company or other legal entity distribute to each such investor, with respect to each such investor’s investment interest therein, is directly proportional to the amount of each such investor’s capital investment therein (including the fair market value of any preoperational services rendered). See Sections 456.053(3)(o)3.f and 456.053(5)(b)1, 2 and 3, Florida Statutes.

³⁹Except for radiologists who have more flexibility with regard to avoiding IDTF status than other kinds of physicians, avoiding IDTF status generally requires that the diagnostic imaging services be rendered by a PA or PLLC (or other legal entity) which furnishes the diagnostic imaging services ancillary to such entity’s provision of professional medical services to its patients. In the case of radiologists, in order to avoid IDTF status, among the other necessary conditions, all owners of the legal entity operating the diagnostic imaging venture must either be radiologists, radiology groups and/or hospitals (or hospital owned subsidiaries) and a substantial portion (generally 75% or more) of the diagnostic tests performed by such venture/legal entity must be interpreted by such legal entity’s physician-radiologist employees or partners.

exception for S corps that were previously C corps or which acquire appreciated assets from C corps in certain non-taxable transactions), net taxable income of both S corps and tax partnerships is taxed solely at the shareholder or partner level (regardless of whether such net income is distributed to the shareholders or partners in whole or in part) and, accordingly, is subject to only one level of tax.⁴⁰

Despite the potential for double taxation on the net taxable income of C corps, beginning principally in 1974 with the adoption of the Employee Retirement Income Security Act of 1974 (“ERISA”) which resulted in there being material differences in the deductibility of employee fringe benefits paid to owner-employees of C corps versus those paid to owners of pass-through vehicles, many professional medical practices were organized or operated through PAs (or regular corporations electing C corp status. These C corporations avoided double taxation on their net taxable income by paying as “deductible wages” all “net practice earnings” remaining after the payment of all practice expenses, other than owner-employee compensation, to their respective owner-employees.⁴¹

Notwithstanding such past practices and any past failure of the Internal Revenue Service to aggressively disallow the deduction of “excess” compensation paid to owner-employees of professional service corporations, the ability of many of today’s physician and other professional medical practices to successfully reduce their “net taxable income” to zero by paying all net practice earnings to their owner-employees as deductible compensation has been brought into doubt, largely because of the special scrutiny compensation paid to owner-employees are subject and both past and relatively recent successful IRS challenges to the deductibility of owner-employee compensation funded with profits derived from sources other than the professional

⁴⁰Based on the maximum marginal income tax rates currently in effect for individuals and the special income tax rates currently in effect (through the end of 2008) with regard to “qualified dividends” paid by domestic (US) corporations, the combined maximum federal and state income taxes assessed at the corporate and shareholder levels on the net taxable income of C corps (constituting personal services corporations) is approximately 50%. After 2008, assuming that present income tax rules which tax qualified dividends paid by domestic US corporations at a maximum rate of 15% are not continued, the combined maximum federal and state income taxes assessed on the net taxable income of C corps constituting professional service corporations will be closer to 60%. Although S corp shareholders are generally not subject to Florida income taxes, if a shareholder or partner of a pass through vehicle is subject to state income taxes, such shareholder’s or partner’s allocable share of the net taxable income of the pass through vehicle will be subject to both federal and state income taxes.

Former C corps electing S corp status at a time when they own any appreciated assets (i.e, any assets having a gross fair market value greater than the corporation’s then adjusted income tax basis therein) and S corps acquiring appreciated assets from C corps in non-taxable transactions pursuant to which the acquiring S corp’s initial adjusted income tax basis in the acquired C corp assets is based on the C corp’s then adjusted income tax basis therein, are generally subject to corporate level (C corp) taxes on the aggregate “net appreciation” inherent in either all corporate assets (in the case of an S election by an existing C corp), as determined immediately prior to the date the S election is effective, or in the acquired C corp assets, as determined as of the date of acquisition thereof, if any such assets are sold or otherwise disposed of at any time within ten (10) years from the effective date of the former C corp’s S election or ten years from the date the existing S corp acquired such appreciated C corp assets, as the case may be. See Code Section 1374.

⁴¹Under Code Section 162, only “reasonable compensation” paid to employees of an incorporated or unincorporated trade or business for services actually rendered are deductible in computing the net taxable income of such trade or business. See Reg. Section 1.162-7. Whether compensation is paid for services and whether compensation which is paid for services rendered is reasonable is based on an examination of all applicable facts and circumstances.

services of the owner-employees, and the fact that many of today's professional physician and other professional medical practices derive significant income from their provision of technical, ancillary medical services.⁴² Further, even if a professional medical practice, organized as a C corp, can properly deduct all compensation which it pays to its owner-employees and thereby reduce their taxable income from operations to zero (because all or substantially all of their net practice earnings are derived from professional medical services of their owner-employees), due to the limits on the deductibility of owner-employee compensation, taxable gain which they will or may recognize on their sale of their practice or practice assets will likely not be subject to offset by the payment of additional salaries or bonuses to their owner-employees and, as such, will likely be subject to double taxation.⁴³

While there does remain today certain differences in the deductibility of certain employee fringe benefits paid by C corps or pass-through vehicles to their respective employees, these remaining differences are relatively insignificant in comparison to the fact or risk of double taxation and, accordingly, should no longer dictate or favor the use of a C corp over the use of a pass-through vehicle to operate professional medical practices or ancillary medical ventures, particularly professional medical practices and ancillary medical ventures having or expecting significant ancillary revenues or which anticipate potentially significant gain upon an eventual sale of their assets or business.

II. **Disregarded Entity Status.** LLCs (including PLLCs) having only one member are not permitted to elect tax partnership status and, unless affirmatively electing either C corp or, if eligible, S corp status for federal and state income tax purposes, will be treated as "disregarded entities" for such purposes. If disregarded entity status applies,⁴⁴ then the sole member (or other owner) of such entity will be required to report on such member's or other owner's individual federal and, if applicable, state income tax return all items of income, gain, loss, deduction or credit otherwise earned or incurred by such entity. As a result of these rules, any individual medical professional who is the recognized owner of a disregarded entity operating a professional medical practice will be required to take into account all items of income, gain, loss, deduction or credit of such entity in computing such individual's self-employment income. The fact that a legal entity is treated as a disregarded entity for federal and

⁴²See for example Richlinds Medical Association v. Commissioner, 953 F.2d 639 (1992) and Pediatric Surgical Associates, P.C. v. Comm., TC Memo 2001-81, 81 TCM 1474 (2001). In both Richlinds and Pediatric Associates, the Service successfully challenged the deductibility of owner-employee compensation which was funded by the subject medical practices' profits derived from technical ancillary medical services and/or from services of its non-owner employees, on the basis that such compensation was a disguised distribution of profits earned from sources other than the professional services of the owner-employees.

⁴³If a professional medical practice can establish that its owner-employees were under-compensated for services rendered prior to a sale of practice assets, then it may be possible to offset all or a portion of any taxable gain recognized upon the sale of their practice assets by using the sale proceeds to pay "catch-up" additional compensation to their owner-employees, provided such additional compensation (funded from such sale proceeds), when added to all other previously paid compensation, constitutes "reasonable" compensation for the professional medical (and other) services rendered by the practice owners over the term of their employment. See for example, Alpha Medical, Inc., 172 F.3d 942.

⁴⁴A partnership (GP or LP) created under state law, which has only one partner recognized for federal income tax purposes, will also be treated as a disregarded entity for federal and state income tax purposes unless it affirmatively elects to be taxed as a corporation.

state income tax purposes does not invalidate such legal entity's status as a separate legal entity for such state law purposes.

Available only to existing S corporations: Existing S corporations are permitted to own 100% of the stock of another domestic corporation and elect to cause such wholly owned subsidiary to become a "Qualified Subchapter S Subsidiary" ("QSSS"), treated as a "disregarded entity" for federal (and state) income tax purposes. However, because of changes to the Internal Revenue Code in 2004 which now require QSSSs to file the same information tax returns as S corps, and because of certain potentially adverse income tax consequences not otherwise applicable in the case of single member LLCs arising from a sale of a portion of a QSSS's outstanding stock to another person, an event which automatically terminates the QSSS election), this Author would, generally, always recommend that S corps desiring to operate any business or activity through a separate legal entity treated as a "disregarded entity" for federal income tax purposes, use a single member LLC to own and operate the same.

III. **S Corps vs. Tax Partnerships (vs. Disregarded Entities).** If a decision is made to use a pass-through vehicle to operate a professional medical practice or ancillary medical venture, the following tax rules applicable to tax partnerships, S corps and disregarded entities and/or to the various legal entities which can be formed under state law and which are capable of electing tax partnership, S corp or disregarded entity status, should be considered when deciding whether to elect S corp, tax partnership or disregarded entity status and/or in deciding which legal entity to form under state law to operate the same.

Federal income tax rules influencing the choice of "pass-through vehicles" and/or the choice of legal entity to use:

(1) Legal Entities Capable of Electing Tax Partnership Status. Only unincorporated legal entities (not including trusts) formed under state law having two or more equity owners (recognized as separate persons for federal income tax purposes) are capable of electing "tax partnership" status. Accordingly, any persons desiring to own and operate a business through a "tax partnership" will be precluded from using a corporation (including PA) organized under state law and, instead, will be required to use either an LLC (including PLLC) or partnership (whether GP or LP) formed under state law for such purpose. Conversely, provided the conditions for electing S corp status are satisfied, any corporation (including a PA), as well as any LLC (including PLLC), GP or LP formed under state law, whether having only one or more equity owners, may elect S corp status.

(2) S Corp Requirements/Comparison with Tax Partnerships.

(a) One Class of Stock. Although S corps may issue voting and non-voting stock, S corps are only permitted to have one class of stock each share of which must have the same rights to profits, losses and distributions as each other share.⁴⁵ Conversely, there are no limitations on the number of different classes of "equity interests" which a tax partnership may have or issue.

⁴⁵Code Section 1361(b)(1)(D).

Although this rule might appear to favor the use of tax partnerships over S corps for the operation of professional medical practices where the parties intend to provide different economic returns to different owner-employees, the one class of stock rule for S corps is not usually a substantive barrier for professional medical practices to elect S corp status since differences in economic returns to be paid among their owner-employees are almost always effected under the owner-employees' employment agreements, through differences in compensation paid for services rendered, rather than through special allocations or distributions of practice profits. However, with regard to ancillary medical ventures which desire to offer preferred returns to investors as a means of inducing an investment therein, the one class of stock rule will preclude the use of an S corp and dictate the use of a tax partnership.⁴⁶

(b) Who May Be An S Corp Shareholder. Shareholders of S corps are limited to natural persons who are either citizens or residents of the United States, certain trusts, including revocable grantor trusts, estates of deceased individuals (but only for a period of up to two years from the date of their death and certain tax-exempt organizations).⁴⁷ Accordingly, a corporation (including a PA), LLC (including PLLC) or partnership (GP or LP) organized under state law which has as a shareholder, member or partner, another state law corporation (including a PA), LLC (including a PLLC) or partnership (GP or LP) or any non-resident alien cannot qualify for S corp status.⁴⁸ Contrary to the limitations on shareholders of S corps, there are no limitations on who may be a "partner" of a tax partnership, regardless of whether organized under state law as a GP (including LLP), LP (including LLP) or LLC, including PLLC.⁴⁹

(c) Limitation on Number of Permitted S Corp Shareholders. The total number of permitted shareholders of an S corp is limited by statute. As of the date of this Article, the number of permitted S corp shareholders is 100.⁵⁰

⁴⁶Any ancillary medical venture desiring to offer investment interests to physicians or other healthcare providers who are subject to the Florida anti-referral laws and who otherwise desire to refer patients to the venture, will be precluded from granting preferred returns to investors who are in a position to refer patients to the venture for the venture's provision of medical services in those situations in which the only available exception under Florida law allowing such patient referrals precludes preferred returns. See Footnote 38.

⁴⁷See Code Section 1361(b)(1).

⁴⁸S corps on the other hand may own 100% of the outstanding stock of another corporation and elect to treat such wholly owned subsidiary as a QSSS. See Code Section 1361(b)(3) and Section 3.II of this Article.

⁴⁹While there are no limits on or requirements as to who may be a "partner" of a tax partnership, in order for an unincorporated business to be recognized as a tax partnership, it must have at least two partners (as determined for state law purposes) recognized as separate persons for federal income tax purposes. Accordingly, even though a legal entity is duly formed and qualified under state law as a partnership because it has two or more separate participants, as recognized for state law purposes, it will not qualify as a tax partnership if one or more of its participants are "disregarded entities" for federal income tax purposes and, as a result, only one person is recognized as a partner thereof for federal income tax purposes.

⁵⁰See Code Section 1361(b)(1)(A). Under certain circumstances, for purposes of determining whether the limit on the total number of permitted S corp shareholders is exceeded, husbands and wives (and their estates) are treated as

Conversely, there are no limitations on the total number of permitted partners of a tax partnership.⁵¹

(3) Self-Employment Taxes. Under Code Section 1402, natural persons (including natural persons who own disregarded entities) are subject to self-employment taxes on the net income which they derive from any trade or business carried on by such persons. Natural persons who are partners of tax partnerships including natural persons who are members of LLCs electing tax partnership status, other than limited partners, are subject to self-employment taxes on their allocable share of their tax partnership's net earnings from its respective trade or business.⁵² Limited partners are not subject to self-employment taxes on their allocable share of the income derived from a trade or business carried on by a tax partnership of which they are a limited partner, other than guaranteed payments, if any, paid a limited partner for services rendered.

Under proposed regulations issued by the IRS in 1997, which have not been finalized to date, an individual partner of a tax partnership including an individual member of an LLC electing tax partnership status, operating a professional medical practice or ancillary medical venture will be treated as a limited partner thereof for self-employment tax purposes, if such partner: (i) has no personal liability (under applicable state law) for the debts or obligations of such tax partnership by reason of being a partner thereof; (ii) does not have the legal authority (under the laws of the jurisdiction in which such tax partnership was formed) to contract on behalf of such tax partnership;⁵³ (iii) participates in such tax partnership's trade or business for less than 500 hours during a given taxable year; and (iv) does not furnish more than a de minimus amount of services to or for the benefit of such tax partnership's healthcare activities.⁵⁴ Although these proposed

a single shareholder, and all members of the same family owning stock in an S corp will be treated as a single shareholder.

⁵¹While there are no limits imposed on the total number of partners in a tax partnership, large or widely held tax partnerships engaged in the operation of a professional medical practice or ancillary medical venture as well as other partnerships engaged in a trade or business will be treated as a publicly traded partnership, generally taxed as a C corp for federal income tax purposes, if, because of its size or nature (or otherwise), interests in the partnership are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent thereof), unless such entity qualifies for and elects S corp status. See Code Section 7704.

⁵²See Code Section 1402. Under Code Section 1402(a)(13), limited partners are only subject to self-employment taxes on "guaranteed payments", if any, made to them by their tax partnerships with respect to services which they actually render to or on behalf of such tax partnerships, to the extent such guaranteed payments are in the nature of compensation for such services.

⁵³Since members of member-managed LLCs organized under Florida law, as well as partners or general partners of Florida organized GPs or LPs, have the statutory authority to bind their LLC (or GP or LP) to contracts which they may enter into in the ordinary course of such LLC's (or GP's or LP's) business, no such members (or partners) would satisfy this condition.

⁵⁴See proposed Regulation Section 1.1402(a)-2. Notwithstanding the general rule of this proposed regulation, an individual member or partner of a tax partnership engaged in a healthcare activity who does not provide more than a de minimus amount of services to such tax partnership's healthcare activities and who otherwise fails to meet one or more of the first three conditions of this proposed rule (for treatment as a limited partner), may still be treated as a limited partner under the proposed regulations with regard to one or more classes of membership or partnership interests which such member or partner may own if persons who are treated as limited partners under this proposed regulation own a substantial continuing interest in such membership or partnership class and such member's or

regulations have never finalized, the IRS has announced, informally, that it will follow these proposed regulations for any individuals who otherwise desire to rely on the same.⁵⁵

To the contrary, shareholders of S corps, including shareholders of S corps operating professional medical practices or ancillary medical ventures, regardless of the level of services they may render to or for the benefit of such medical practices or medical ventures, are not subject to self-employment taxes on their allocable share of their S corp's net earnings, provided they are paid reasonable compensation for the services, if any, which they actually render to or for the benefit of their S corp.

If a decision is made to use a tax partnership to operate a professional medical practice or ancillary medical venture, in light of the above described self-employment tax rules, individual owners intending or expecting to provide more than a de minimus amount of services to or for the benefit of such practice or venture may want to consider causing such practice or venture to be operated by an LP which elects tax partnership status, and to hold all or up to 99% of their equity interests therein as a "limited partner" thereof or, if operated through an LLC or GP (or LLP), treated as a tax partnership, to hold their membership or partnership interests therein through a corporation (including a PA), electing S corp status, so as to avoid the imposition of self employment taxes on all of their allocable share of the net profits of such practice or venture.⁵⁶

(4) Tax Treatment on Owner's Sale of Equity Interests. Contrary to the federal income tax rules applicable to the sale of equity interests in tax partnerships having unrealized receivables within the meaning of Code Section 751(c)⁵⁷ or inventory items within the meaning of Code Section 751(d) (which rules can result in a selling partner having to recognize ordinary income, rather than only "capital gains", on the sale of their equity interests therein), a shareholder's sale of stock in an S corp will always

partner's rights and obligations with regard to that class of membership or partnership interests are identical to the rights and obligations with regard to such class possessed by the limited partners. See Proposed Reg. Sections 1.1402(a)-2(h)(3) and (4).

⁵⁵If these proposed regulations are finalized in their present form, then limited partners of LPs organized under state law to operate a healthcare business or activity will or may not be treated as a "limited partner" thereof for self-employment tax purposes and, accordingly, will or may be subject to self-employment taxes on their allocable share of such LP's trade or business net income, if they provide more than a de minimus amount of services to or for the benefit of such healthcare business or activity. However, until finalized, limited partners of LPs organized under state law and treated as tax partnerships for federal income tax purposes should be treated as limited partners thereof for self-employment tax purposes and, accordingly, would only pay self-employment taxes on guaranteed payments they may receive for services rendered, under the general statutory rules of Code Section 1402, regardless of the level of services they may render.

⁵⁶If an LLC or GP, electing tax partnership status, is otherwise to be used to operate a professional medical practice or ancillary medical venture, then before a participant therein makes a decision to hold their membership or partnership interest therein through a legal entity treated as an S corp for federal income tax purposes, such participant should determine whether utilizing an S corp to hold such membership or partnership interest will adversely impact the anticipated tax benefits which such participant otherwise expects to derive from utilizing a tax partnership to operate such practice or venture.

⁵⁷For this purpose, "unrealized receivables" include depreciation recapture inherent in a tax partnership's depreciable assets and all zero basis accounts receivable.

only give rise to capital gains.⁵⁸

Although the potential difference in the characterization of gain for income tax purposes arising from the sale of equity interests in S corps and tax partnerships is not usually a determinative factor in selecting between a tax partnership or S corp for the operation of a professional medical practice or ancillary medical venture, this potential difference in tax characterization and the resulting potential difference in income taxes payable upon a sale of an owner's interest therein could influence the election of S corp status over tax partnership status if all other factors between selecting between S corp or tax partnership status are equal or, if this factor, when added to other potential benefits of S corp status, including differences in self-employment taxes, otherwise favor S corp status over tax partnership status.

(5) Calculation of Shareholders'/Partners' Income Tax Basis in S Corp/Tax Partnership. A shareholder's or partner's income tax basis in their S corp stock or tax partnership interest is relevant, among other purposes, for calculating the gain or loss which a shareholder or partner will or may recognize upon the receipt of cash (or in-kind) distributions and the total S corp or tax partnership losses which a shareholder or partner will generally be permitted to deduct (on their personal income tax return) for federal (and, as applicable, Florida) income tax purposes. While the calculation of a shareholder's and a partner's income tax basis in S corp stock or tax partnership interests are generally similar, a partner's income tax basis in a tax partnership, unlike a shareholder's basis in S corp stock, includes the partner's allocable share of a tax partnership's outstanding indebtedness, as determined from time to time.⁵⁹ As a result of the differences in basis calculation, partners of tax partnerships, unlike shareholders of S corps (subject to other applicable rules which may limit otherwise permissible deductions, including "at risk" rules under Code Section 465 and the passive activity loss rules under Code Section 469), can generally deduct aggregate partnership losses (for a given year) in an amount in excess of their then total "net investment" therein (i.e., their unreturned capital contributions plus their share of undistributed partnership profits) and/or can receive, tax free, aggregate cash distributions in an amount greater than their net investment therein.

While differences in basis calculation may not be an important factor when deciding whether to operate a professional medical practice through a tax partnership or S corp (generally because most professional medical practices do not typically generate excess tax losses or make equity distributions funded by practice borrowings), these differences

⁵⁸Under present income tax laws, long term capital gains are taxed at a maximum rate of 15%, while ordinary income is taxed to individuals at a maximum marginal rate of 35%. If stock in a corporation sold by a selling shareholder was owned by the selling shareholder for more than one year at the time of sale, then all gain recognized on such sale by the selling shareholder will be taxable as long-term capital gains.

⁵⁹See Code Sections 705, 722 and 752, and Code Section 1366. Notwithstanding this general rule, under Code Section 1366, an S corp shareholder can deduct on his or her individual income tax return (subject to other limits on loss deductions imposed under the Code), S corp losses otherwise allocated to such shareholder up to the sum of such shareholder's adjusted income tax basis in his or her S corp stock and such shareholder's then adjusted basis in his or her outstanding loans, if any, to the S corp.

in basis calculation can be an important (if not decisive) factor for electing tax partnership status for ancillary medical ventures which anticipate substantial debt financing to acquire significant, depreciable medical equipment or other depreciable assets which are expected to generate, for one or more years, significant tax losses and/or significant cash flow in excess of net taxable income.

(6) In-Kind Property Distributions. Under the provisions of Subchapter C of the Code which are applicable to S corps,⁶⁰ liquidating and non-liquidating distributions of appreciated property by S corps will result in the immediate recognition of taxable gain by the S corp (which in turn will or may be taxable to all S corp shareholders, depending on the other net income or net loss of the distributing S corp) in an amount equal to the excess of the distributed property's gross fair market value (as determined as of the date of distribution) over the distributing S corp's then adjusted income tax basis therein. Contrary thereto, distributions of appreciated property by tax partnerships, whether or not distributed in liquidation of the tax partnerships or any partner's interest therein, will generally not trigger taxable gain (or other taxable income) to either the distributee or non-distributee partners.⁶¹

While this rule is not generally a decisive factor when selecting between an S corp or tax partnership for the operation of most professional medical practices (because most professional medical practices do not anticipate making distributions of property in kind to its owners), this rule can be an influencing factor (for electing tax partnership status) for ancillary medical ventures generally formed between two (or few) participants who intend that upon termination thereof, the assets of the venture, if not otherwise sold to a third party, will be divided among such participants in some pre-agreed fashion, and possibly for those professional medical practices, the practice assets of which are to be

⁶⁰See Code Section 311(b).

⁶¹See Code Section 731(a) and 731(b). Notwithstanding this general rule, if the distribution of property in-kind by a tax partnership results in a distributee partner receiving a disproportionate share of either the tax partnership's "Code Section 751" assets (unrealized receivables or substantially appreciated inventory items) or its non-"Code Section 751" assets, then either the distributee partner or the non-distributee partners will or may be required to recognize ordinary (taxable) income as a result of such distribution under Code Section 751. [See Code Section 751(b).] Further, if a partner contributes appreciated property to a tax partnership and within seven years from the date of such contribution, the contributed property is distributed by the tax partnership to another partner or the tax partnership distributes other partnership property to the contributing partner, then the contributing partner, as a result of such distribution, will or may be required to recognize taxable gain under Code Section 704(c)(1)(B) or Code Section 737. In addition, if the distributed property consists of marketable securities, then, unless such marketable securities were originally contributed to the tax partnership by the distributee partner or the tax partnership qualifies as an "investment partnership", the distribution of such marketable securities by the tax partnership to the distributee partner will be treated as a distribution of cash and, accordingly, the distributee partner will be required to recognize taxable income as a result of such distribution if and to the extent that the fair market value of such marketable securities (as determined of the date of distribution) exceeds the distributee partner's adjusted income tax basis in the distributing tax partnership, as determined immediately prior to the distribution of such marketable securities. See Code Section 731(c). Lastly, as provided by Code Section 707(a)(2)(B) and the regulations promulgated pursuant thereto, if a non-pro rata distribution of property by a tax partnership to a partner is made within two years before or after the distributee partner's transfer of other property (including cash) to the tax partnership, such property distribution will or may be (rebuttably) presumed to be part of a disguised, taxable sale or exchange of property by and between the distributee partner and the tax partnership. See Regulation Sections 1.707-1 through 1.707-9.

contributed, in whole or in part, by one or more of the practice participants under an arrangement which calls for such contributed assets to be returned (via a distribution) to the respective contributing participants upon their withdrawal from the practice or otherwise upon the dissolution of such practice.

(7) Tax Consequences of Contributions to Capital. In general, contributions of both cash and property to either an S corp or a tax partnership, in return for stock or partnership interests therein, do not trigger gain or loss to either the contributing shareholder or partner or to the S corp or tax partnership.⁶² Notwithstanding this general rule, the contribution of appreciated property to an S corp (or C corp), for shares of stock, will be taxable to the contributing shareholder if the contributing shareholder does not “control” [within the mean of Code Section 368(c)] the S corp (or C corp) immediately following such contribution, unless such appreciated property is contributed as part of a transaction pursuant to which such contributing shareholder and one or more other persons, who individually or collectively, do or will control the S corp (or C corp), contribute property to the S corp (or C corp) in consideration for shares of stock therein.⁶³ Further, an individual who contributes services in consideration for shares of stock in an S corp (or C corp) or who otherwise receives stock in an S corp (or C corp) in connection with such individual’s performance of services to or for the benefit of such corporation, generally, will be required to recognize taxable (ordinary) income⁶⁴ (either in the year in which such stock is issued or, if subject to a “substantial risk of forfeiture”, in the first year thereafter during which such risk of forfeiture lapses or such person’s rights in such stock are transferable) in an amount equal to the excess, if any, of the fair market value of the stock so received (as determined as of the date of receipt thereof or, if applicable, at such later time as such stock is no longer subject to a substantial risk of forfeiture or is transferable, whichever occurs first), over the amount, if any, which such individual paid for such stock.⁶⁵ If an S corp’s (or C corp’s) grant of

⁶²See Code Sections 721(a) and 351(a).

⁶³Under Code Section 368(c), a person or persons will be deemed in control of a corporation if such person or persons, individually or collectively, own stock of the corporation possessing at least 80% of the total combined voting power of all classes of its stock and own at least 80% of the total number of shares of all classes of stock of such corporation.

⁶⁴See Code Section 83(a)

⁶⁵Under Code Section 83(c)(1), the rights of a person in shares of stock will be deemed subject to a “substantial risk of forfeiture” if such person’s rights to full enjoyment of such stock are conditioned upon the future performance of substantial services by such person. Further, under Code Section 83(c)(2), the rights of a person in shares of stock are deemed transferable only if a transferee’s rights in such stock are not (or would not be) subject to a substantial risk of forfeiture. Under Code Section 83(d), if shares of stock issued to a shareholder in consideration for the performance of services are subject to a restriction which by its terms will never lapse and which allows such shareholder to sell such stock only at a price determined by a formula, then the price so determined will, generally, be deemed to be the fair market value of such shares of stock. Under Code Section 83(b), if stock received in connection with the performance of services is subject to a substantial risk of forfeiture, a person may elect to value such stock (without regard to such substantial risk of forfeiture and any other restriction, other than a restriction which by its terms will never lapse) (and report any income arising from the issuance thereof) at the time (and for the year) that it is issued. The election allowed under Code Section 83(b) is required to be made by filing a notice with the IRS within 30 days after the date the stock is issued. If such election is made and the subject stock so received is later forfeited, the recipient-shareholder is not entitled to a deduction as a result of such forfeiture.

stock to an individual in connection with such individual's performance of services is taxable to the recipient shareholder, then the S corp (or C corp) may be entitled to a deduction (if an otherwise deductible expense under Code Section 162) in an amount equal to the taxable income recognized by such recipient by reason of the receipt of such stock, for the S corp's (or C corp's) taxable year during which the recipient is required to recognize such taxable income.

Contrary to the above described rules for corporations and their shareholders, the contribution of appreciated property to a tax partnership (excluding an "investment partnership"), regardless of whether the contributing partner "controls" the tax partnership immediately after such contribution (or at any other time) or whether such contribution is part of a transaction in which such partner, together with other persons in control of the tax partnership, contribute property to the tax partnership, will, generally, always be non-taxable to both the contributing partner and the tax partnership.⁶⁶ Further, a tax partnership's issuance of a profits interest (and not a capital interest) to a new or existing partner in connection with the performance of services to or for the benefit of such tax partnership, generally, does not create taxable income to the recipient partner⁶⁷ (or to the tax partnership).

⁶⁶Contrary to this general rule, if the contribution of property to a tax partnership by a partner is deemed part of a disguised sale or exchange of property between such partner and the tax partnership, then the contribution of such property will be a taxable event. See Code Section 707(a)(2)(B) and Regulation Sections 1.707-1 through 1.707-9.

⁶⁷See Rev. Proc. 93-27, 1993-2 CB 343, clarified by Rev. Proc. 2001-43, I.R.B. 2001-34, 191 and Proposed Reg. Section 1.83-3(e)(1). Under Rev. Proc. 93-27, a tax partnership's grant of a profits interest (whether vested or not vested) to a person who provides services to or for the benefit of the tax partnership in such person's capacity as a partner thereof or in anticipation of becoming a partner thereof is a non-taxable event for both the tax partnership and the service partner unless: (i) the profits interest received relates to a substantially certain and predictable stream of income from the tax partnership's assets (such as income from high quality debt securities or a high quality net lease); or (ii) the service partner disposes of such profits interest within two years of receipt thereof; or (iii) the profits interest is a limited partnership interest in a publicly traded partnership [within the meaning of Code Section 7704(b)].

Under the proposed Section 83 regulations, which, when finalized, will supercede and replace Rev. Proc. 93-27 for partnership interests issued for services on and after the date the final Section 83 regulations are published in the Federal Register, a tax partnership's grant of a partnership interest (whether a profits interest or capital interest), in consideration for the performance of services, will be taxable to the recipient partner under Code Section 83(a), based on the excess of the fair market value of such partnership interest over the amount, if any, paid by the recipient partner therefor. However, if finalized in the present form, the Section 83 regulations will allow tax partnerships to elect (if certain conditions are met) a safe harbor under which the fair market value of profits interests issued for services while such election is in effect will be treated as equaling their "liquidation value". (The liquidation value of a partnership interest, as determined as of any date, is the amount, if any, which the holder of such interest would receive as of such date with respect to such interest if the applicable tax partnership, as of such date, sold all of its assets for all cash for their then fair market value in a fully taxable transaction and, after paying off its then outstanding liabilities and allocating the sale gain or loss resulting therefrom among its partners (and adjusting the partners' respective capital accounts to reflect their share of such hypothetical gain or loss), distributed the proceeds of such sale, remaining after the payment of its then outstanding liabilities, among its partners (as otherwise required by the terms of the tax partnership's partnership agreement), in liquidation of the tax partnership and the partners interests therein.

For tax partnerships which employ capital account maintenance rules under Code Section 704(b) and which liquidate their partners' interests in the tax partnership based on their ending positive capital account balances, the

While the potential differences in income tax consequences resulting from the grant of stock in an S corp versus the grant of a profits interest in a tax partnership for or in connection with the performance of services could favor the selection of a tax partnership to operate both professional medical practices and ancillary medical venture which intend to issue equity interests therein in consideration for the performance of services thereto, most professional medical practices, if operated through S corps (or C corps), could minimize, if not eliminate, the income tax consequences to their shareholders resulting from their receipt of stock for services by requiring that they become parties to a binding written agreement which obligates such shareholders, in all events, to sell their stock in the S corp (or C corp) for its then adjusted book value (or, if applicable, for the same fixed price they originally paid for such stock) and, if desired, requiring that all shareholders, including service “partners”, purchase their stock in the corporation for its then adjusted book value (or for some fixed price). However, in cases, principally of ancillary medical ventures (and possibly certain professional medical practices), which own or otherwise intend to acquire ownership of substantial real or personal property and which either will not require their equity owners to become parties to an agreement which restrict the transferability of their equity interests therein or otherwise require that their equity owners sell their equity interests therein for less than fair market value, and which otherwise intend to offer more than de minimus equity interests therein to one or more equity participants solely or primarily for the performance of services, and/or in the case of professional medical practices or ancillary medical ventures which otherwise expect or intend to have individual participants (not otherwise in “control” thereof) contribute (in separate, unrelated transactions) substantially appreciated real or personal property, the difference in income tax consequences arising from the issuance of shares of stock in S corps (or C corps) or a profits interest in tax partnerships, in consideration for the performance of services, and/or arising from the contribution of appreciated property to S corps (or C corps), on one hand, or to tax partnerships, on the other hand, will or may favor the use of a tax partnership to operate the same.

4. Examples of Choice of Entity/Tax Election. The following sets forth examples of those factual situations involving either the operation of a professional medical practice or an ancillary medical venture which would influence the selection of the following described respective legal entities, having the following described respective tax status:

I. **Example 1 - PA, Electing S Status, to Operate a Professional Medical Practice.** Two or more duly licensed medical professionals (100 or less) desire to organize a legal entity to operate a professional (physician) medical practice (either single specialty or multi-specialty). It is anticipated that the medical practice will also offer a variety of ancillary (technical) medical services to practice patients, in furtherance of the evaluation and/or treatment of practice patients, including diagnostic imaging and clinical laboratory services.

Recommend that a regular corporation, qualifying as a professional corporation (PA), under

liquidation value of a profits interest, as determined as of the date that it is first issued, will always equal \$0. A profits interest received for services will be valued for purposes of Section 83(a) as of the date of issuance if it is not subject to a substantial risk of forfeiture or, if it is, if the service partner receiving the same timely files a Section 83(b) election with respect thereto.

Chapters 607 and 621, Florida Statutes, be formed, and that the PA elect to be taxed as an S corp for federal (and state) income tax purposes.

In addition to other net benefits achieved (including reduced organizational costs when compared to using an LLC or PLLC, liability protection to the owners and a single level of income taxes on net practice profits), this legal structure and income tax election will allow the owner-shareholders to share net ancillary profits generated from the practice's ancillary medical services (based on their relative ownership of the outstanding stock of the PA), without incurring self-employment taxes on such net ancillary profits. [Although both licensed and non-licensed judgment creditors of the PA shareholders would legally be able to foreclose on a debtor-shareholder's PA stock, PA status itself prevents individual shareholders from voluntarily transferring their equity interests in the professional medical practice to non-licensed individuals, and will or may enhance enforceability of a stock restriction and shareholders agreement which the PA will or may require its shareholders become parties to, including provisions thereof which grant the PA an option re-purchase a shareholder's PA stock if acquired by a judgment creditor (or if otherwise transferred, voluntarily or involuntarily, in contravention of the terms thereof).]

II. Example 2 - Use of an LLC, Electing Tax Partnership Status, With Members Forming PAs, Electing S Status, to Operate Professional Medical Practice. Two or more duly licensed medical professionals, together with a legal entity owned by one or more non-licensed individuals, desire to organize a legal entity to operate a professional (physician) medical practice (either single-specialty or multi-specialty). Most, but not all, of the licensed medical professional owners will furnish medical services to or on behalf of the medical practice. It is anticipated that this medical practice will offer a variety of ancillary (technical) medical services to practice patients, in furtherance of the evaluation and/or treatment of practice patients, including diagnostic imaging and clinical laboratory services. The licensed medical professionals desire the involvement of the legal entity owned by non-licensed individuals because this legal entity has agreed to contribute all or substantially all of the capital needed to acquire practice assets and establish and operate the medical practice. The licensed medical professionals not contributing cash or other property to the practice have agreed to contribute their services in consideration for a profits interest in the practice.

Recommend that a manager-managed LLC be formed, under Chapter 608, Florida Statutes, and that the LLC elect to be treated as a tax partnership for federal (and state) income tax purposes. Further recommend each individual medical professional, who otherwise will provide professional medical services to or on behalf of the medical practice, form a corporation, under Chapters 607 (possibly qualifying as a professional corporation under 621), Florida Statutes, to hold their respective membership interest therein and that each corporation (or PA) elect to be taxed as an S corp. (Because of the involvement, as an equity owner, of a legal entity, not qualifying as a PA, this practice could not be operated through a PA. Further, because at least one of the owners of this practice will be another legal entity not qualified to be a shareholder of an S corp, this practice cannot be operated through an S corp.)

In addition to the other net benefits achieved (including a single level of income taxes on net practice profits and no taxable income to service partners on their receipt of a profits interest in the practice in consideration for their contribution of services), none of the medical professional owners, including those performing services for the practice, will be subject to self-employment

taxes on their allocable share of the practice's net ancillary profits (assuming each member furnishing professional medical services to or on behalf of the practice is paid reasonable compensation for such services). (As a manager-managed LLC, none of the members will have the legal authority to bind the tax partnership to any contracts or transactions. Accordingly, the LLC members not otherwise providing professional services to or on behalf of the medical practice can qualify as "limited partners" of the LLC for self-employment tax purposes under the proposed self-employment income tax regulations discussed in this Article. Further, those medical professionals who will provide professional medical services to or on behalf of the practice, but who hold their membership interests through a corporation, electing S corp, as shareholders of an S corp, will also avoid self-employment taxes on their allocable share of the practice's net ancillary profits, assuming they are paid reasonable compensation for the services which they do render to or on behalf of the practice.)

III. **Example 3 - Use of a General Partnership (or LLP) Electing Tax Partnership Status, to Operate an Ancillary Medical Venture.** A for-profit home health agency and a not-for-profit hospital desire to form a home health venture, serving the community otherwise served by the not-for-profit hospital. The not-for-profit hospital desires that the home health services be furnished in furtherance of its charitable purposes so that its share of the venture's net income not be subject to federal (or state) income tax. The tax exempt hospital has expressed a desire that it be able to terminate the venture (or its involvement in the venture), and be paid its share of the venture's net value (or receive a distribution of its share of the venture's business and assets), should its allocable share of venture income become subject to federal income tax (as "unrelated business taxable income") or if venture operations, or its participation in the venture, otherwise adversely impact its tax exempt status.

Recommend that a registered Florida general partnership, organized as a limited liability partnership (LLP), be formed under Chapter 620 (FRUPA), and that the LLP elect "tax partnership" status.

Among other net benefits achieved (including no personal liability for venture liabilities and a single level of income tax, or no income tax to the tax exempt partner, on net venture profits), interests in this venture will not be subject to Florida intangible tax; the tax exempt partner (as well as the other partner) will be allowed to withdraw from the venture at any time and, effectively, force either a dissolution of the venture or a mandatory purchase of the withdrawing partner's interest therein (for its fair value); and no income taxes will be triggered if venture assets are distributed in kind among the participants upon termination of the venture, assuming either a pro rata distribution of all venture assets or, if a non-pro rata distribution, the absence of "unrealized receivables" and "inventory property" (as such terms are defined in Code Section 751).

IV. **Example 4 - Use of an LLC, Electing Tax Partnership Status, to Operate Ancillary Medical Venture.** A radiology group and hospital desire to joint venture the operation of one or more diagnostic imaging facilities under an arrangement pursuant to which one or both participants will contribute one or more existing diagnostic imaging centers (and/or the assets used with respect thereto), both participants desire to have equal management rights, the radiology group does not want the hospital to be able to unilaterally withdraw (or have the

right to withdraw) from or to dissolve the venture and, in the event that, upon the dissolution of the venture, the venture's business and assets are not sold to a third party in a sale transaction mutually approved by both participants, the diagnostic imaging facilities (and assets used or held for use thereat) owned by the venture are to be divided among the two participants in a pre-agreed manner. It is further agreed that the radiology group, in its capacity as a venture participant, through its physician-employees, will read and interpret all or substantially all (75% or more) of the diagnostic tests performed by the venture, in consideration for the allocation and payment of all professional fees otherwise payable to the venture for such professional interpretive services.

Recommend that a member-managed LLC be formed under Chapter 608, Florida Statutes, and that the LLC elect tax partnership status.

Among other net benefits achieved (including single level income taxes and no self-employment taxes on net venture profits), by restricting ownership in the venture to the radiology group (and/or its individual radiologists) and the hospital (or hospital subsidiary) and having all (or substantially all) of the diagnostic tests performed by the venture be interpreted by the physician-employees of the radiology group, on behalf of the radiology group, in the radiology group's capacity as a member (partner) of the LLC (tax partnership), the LLC can qualify as a "physician group" under the Medicare program (thus avoiding IDTF status), and the total self-employment taxes (employer-employee) otherwise payable with respect to the aggregate compensation paid the individual radiologists for all professional services they render (both to and outside this venture), will be minimized to the maximum extent possible; and, upon the dissolution of the venture, the assets of the venture can generally be distributed among the radiology group and the hospital venture participants without such distribution triggering any taxable income.

As a variation of the above, if the radiology group is a C corp or if individual shareholders of the radiology group desire to own "their" share of the venture's net equity outside of the radiology group (so as to protect such net equity from claims of the radiology group's creditors arising from its activities unrelated to the new venture), consider recommending that the radiology group/radiologists hold their interest in this venture through a limited partnership (LP or LLLP), of which the radiology group will be the 1% general partner and the individual radiologists will be the 99% limited partners. Under these facts, by adopting this variation, 99% of the venture net profits otherwise allocable to the radiology group will avoid double taxation and/or 99% of the net equity in the venture otherwise to be owned by the radiology group/radiologists would not become subject to the claims of the radiology group's creditors (arising from unrelated activities of the radiology group). (To accomplish this, 99% of the aggregate capital contributions otherwise to be made by the radiology group to the venture would have to be funded by the shareholders of the radiology group or the shareholders of the radiology group would have to purchase, for full value, the radiology group's interest in the venture.) The radiology group needs to remain as a 1% general partner in the participating LP or LLLP so as to ensure the venture's status as a physician group (and not an IDTF) for Medicare Program purposes and/or to minimize (to the maximum extent possible) the total self-employment taxes (employer-employee) otherwise payable with respect to the aggregate compensation paid the individual radiologists for their professional services (both those related and unrelated to this venture).

V. **Example 5 - Use of an LP (LLLP) Electing Tax Partnership Status, to Operate Ancillary Medical Venture.** An existing radiology group, taxed as a C corp, and its owners, desire to acquire and operate one or more diagnostic imaging centers either alone or with one or more unaffiliated radiologists (or other radiology groups), and desire to protect the radiology group's interest in its existing assets from claims of creditors of the new centers. The owners of the existing radiology group desire to avoid double taxation on the net profits generated from the operation of such centers and further desire to protect the net equity in the centers (and the equipment purchased for the operation thereof) from claims of creditors of the radiology group (arising from its activities unrelated to the new diagnostic imaging centers). The radiology group, through its physician-employees, will interpret all or substantially all (at least 75%) of the diagnostic tests performed at the new diagnostic imaging centers, in consideration for the allocation and payment of all professional fees otherwise payable for such interpretive services.

Recommend the formation of a limited partnership (qualifying as "limited liability limited partnership") under Chapter 620 (RE:RULPA), and that the LLLP elect "tax partnership" status. It is further recommended that the existing radiology group become the 1% general partner, with the shareholders of such radiology group (and, as applicable, other participating radiologists) owning the remaining 99% equity interests therein, as the sole limited partners thereof.

Among other net benefits achieved [including the avoidance of double income tax and self-employment taxes on all or on 99% of the net profits or net ancillary profits generated from the operation of the new diagnostic imaging centers, shielding the assets of the radiology group, unrelated to the new centers, from claims of creditors of the new diagnostic imaging centers (other than claims arising from the actions or inactions of the radiology group's physician-employees in their performance of professional interpretive services for the new centers) and insulating 99% of the net equity in the new diagnostic imaging centers from claims of creditors of the radiology group, arising from its activities unrelated to the new diagnostic imaging centers, while providing the radiology group with full control over the new centers operations and activities], none of the equity interests in the venture will be subject to Florida intangible tax, the LLLP can qualify as a "physician group" under the Medicare program, thus avoiding IDTF status, and the total self-employment taxes (employer-employee) otherwise payable with respect to the aggregate compensation paid the radiology group's individual radiologists for all professional services they render (both those related and unrelated to the new centers) will be minimized to the maximum extent possible.

VI. **Example 6 - Use of an LP (LLLP) Electing Tax Partnership Status, to Operate Ancillary Medical Venture.** A promoter desires to form an ancillary medical venture (furnishing non-designated health services, in whole or in part) and to offer equity interests therein to both medical professionals who may be in a position to refer patients thereto and non-medical professionals. It is anticipated that some of the medical professionals to whom equity interests are marketed will provide services to or on behalf of the new venture. The promoter desires full and absolute control over all aspects of the business of the ancillary medical venture (other than clinical matters which are to be delegated, in full, to a committee comprised of qualified medical professionals owning an equity interest in the venture). In order to entice investors, all or certain of the investors are to be offered preferred returns on their investment (before the promoter shares in venture income or profits), however, those investors offered a

preferred return will have a reduced interest in residual profits (remaining after payment of their preferred return).

Recommend that a limited partnership, qualifying as an LLLP, be formed under Chapter 620 (RE:RULPA) and that the LLLP elect tax partnership status. Further recommend that the promoter become the sole general partner of the LLLP (owning an interest in venture profits and losses not otherwise allocable to the limited partners), and that two different classes of limited partnership interests be created, as follows: (i) limited partnership interests having a preferred return (but a reduced interest in residual profits), to be offered to non-medical professionals and to medical professionals not otherwise in a position to refer patients to the venture; and (ii) a class of limited partnership interests (representing not more than 50% of total venture profits, losses and capital) which provide the holders thereof with a pro rata share of all venture profits, losses and distributions (based on the holders' relative capital contributions to the venture), to be offered to both medical professionals or immediate family members of medical professionals who are otherwise in a position to refer patients to the venture and to other prospective investors who prefer such investment class to the investment class entitled to a preferred return.

Among other net benefits achieved (including a single level of income taxes on venture profits, no self-employment taxes on any investor's allocable share of venture profits, full control over venture operations by the promoter and no liability to venture creditors by either the promoter or by these medical professionals delegated authority to manage venture clinical operations, in their respective capacities as "partners" thereof), medical professionals investing or whose immediate family members investing in the LLLP, assuming investment interests in both limited partnership classes are offered and sold on the same terms and conditions to all persons, will be legally permitted to refer their patients to the LLLP for its provision of non-designated healthcare services; assuming compliance with the capital account maintenance rules imposed by Code Section 704(b) regulations, the special allocations of venture profits or losses among the class of limited partners entitled to a preferred return and to the promoter will be respected by the IRS; and none of the interests in the LLLP will be subject to Florida intangible taxes.