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Jeffrey O'Brien, an attorney with Lommen Abdo in Minneapolis, says, "With an S corporation, you can pay yourself a salary, pay FICA and Medicare tax on that salary, and take draws beyond that salary without the FICA obligation." Staff photo: Bill Klotz

Solo Practice: Rules (or at least guidelines) of incorporation for solos

By: Dan Heilman March 31, 2016 0

It's time for you to make the jump to a fulltime solo practice. Maybe you're just out of law school or you're leaving a firm. What do you need to know about incorporating a practice?

The first thing to consider is which type of incorporation to use, since Minnesota law firms must be incorporated. The most common forms of business are the sole proprietorship, partnership, corporation, limited liability company (LLC) and S corporation. (Lawyers must add a "professional" tag to those designations.)

A sole proprietorship might make sense if you're only taking on occasional freelance assignments or temporary in-house gigs. But declaring yourself a sole proprietorship could mean sacrificing tax benefits accessible to corporation, as well as exposing your personal assets to creditors.

The primary advantage of an LLC is the shield it provides. The owner of an LLC is protected from some or all liability for the acts and debts of that corporation. Meanwhile, an S corporation (named for Subchapter S of Chapter 1 of the Internal Revenue Code) joins the limited liability benefits of a corporation with the tax benefits of a partnership.

"On the tax side, with an LLC, you have full self-employment tax on every penny of income that you bring in," said Jeffrey O'Brien, an attorney with Lommen Abdo in Minneapolis. "With an S corporation, you can pay yourself a salary, pay FICA and Medicare tax on that salary, and take draws beyond that salary without the FICA obligation. Self-employment tax also gets minimized with an S corporation structure."

Another feature of an S corporation is that the IRS lets the owner cap payroll taxes at the owner's salary level instead of imposing the self-employment tax on all income under a certain threshold.

Less recordkeeping

Sometimes law firms form as a single-member LLC, complete with articles of incorporation, an operating agreement and other corporate documents. With an S corporation, you have file a separate tax return, form 1120S, as a shareholder.

"If you go with an LLC, you can be a disregarded entity for federal income tax purposes," said O'Brien. "You just report the income for the LLC on schedule E of your personal return. Because you don't have to file two separate returns as an LLC, as you would with an S corporation, that's money you don't have to give your accountant."

An LLC also requires far less recordkeeping than some other entity types, and it offers a degree of flexibility: An LLC can have more than one owner, or member. Members can include individuals, corporations, other LLCs and foreign entities, and there is no maximum number of members.

The LLC laws in Minnesota changed two years ago with the passage of the Revised Uniform Limited Liability Company Act, which moves Minnesota LLCs from a corporation-based model to a partnership-based model and permit a series LLC, or several entities operated by one LLC, all with their own assets and owners.

Whichever entity you choose, after filing organization and incorporation documents with the Secretary of State's Office, you must also file copies of your articles of incorporation or registration statement with the state Lawyers Professional Responsibility Board.

Hire a pro

A number of companies offer automated online ways of incorporating, but Richard Clem, a Minneapolis attorney and CLE instructor, recommends doing the paperwork yourself, or with the help of a corporate attorney.

"LegalZoom and companies like that do a good job, but the concern I have with forming a corporation with a service like that is that they generally don't prepare the basic set of corporate documents that you'll need on hand," Clem said. "Documents such as corporate bylaws, meeting minutes and stock certificates are things you want to have access to if it's ever questioned whether you're following all the corporate formalities."

Another aspect to consider is the Minnesota Professional Firms Act, which sets forth requirements and principles pertaining to professional corporations and authorizes practitioners of some licensed professions to choose to be professional firms. It's an opt-in statute, but paradoxically, the Minnesota Lawyers Professional Responsibility Board requires lawyers to opt in to it.

"It's a fascinating statute," said O'Brien. "Lawyers, veterinarians, chiropractors are required to opt in to it, but not every professional is."

Corporate lawyers, naturally, encourage lawyers about to incorporate to work with an attorney with expertise in that area.

"Work with somebody who knows how to set up a business entity and a professional firm," says O'Brien. "If you're not comfortable being your own corporate lawyer, hire someone to do it for you. Lawyer can help you form a corporation, defend that corporation in malpractice and ethics issues."