Professional Corporation (PC)
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What is it?

The professional corporation (PC) is a type of corporation whose shareholders are members of designated professions. A PC is treated as a single entity, may raise its own money by selling stock to shareholders, and usually handles its profits by either distributing them to shareholders or reinvesting them in the business. A PC can designate itself either as a C corporation or an S corporation for taxation purposes. This type of corporation is unique, primarily because its shareholders must generally be members of a licensed profession. Each state defines by statute the professions that may form a PC. Lawyers, physicians, dentists, accountants, architects, and psychologists are among the professionals that are typically eligible. Prior to the enactment of PC statutes, members of these professions were not permitted to practice in most states using a corporate form.

When can it be used?

Must have minimum number of shareholders set by state statute

State statutes set forth the minimum number of shareholders in a professional corporation (PC). Frequently, the number is one, but in some states, the minimum is higher. Consult a corporate attorney for the specifics in your state.

Must generally have only shareholders from a specific, eligible profession

State statutes define which professions are eligible to form PCs. Generally, the eligible professions correspond to those that must be licensed in a given state. Check your particular state's law to determine whether members of your profession are eligible to form a PC or, in fact, must form one if they intend to incorporate.

Caution: Once you have determined that your profession can form a PC, your corporation must have shareholders of only one profession. Lawyers and architects, for example, will not be able to join together to form a PC.

Strengths

Allows licensed professionals to take advantage of limited liability features of a corporation

This feature is especially important for service professionals who, prior to the enactment of professional corporation (PC) statutes, could not practice under the corporate form in most states. Physicians and lawyers, for example, are vulnerable to malpractice suits for negligent actions toward clients or patients. In a partnership, individual partners can be held liable for their fellow partners' negligence. In a PC, however, they generally are not personally liable for their fellow shareholders' negligence. They face liability only to the extent of their investment in the corporation. They can still face personal liability for their own negligence toward their clients or patients.

Tip: Many states now also allow limited liability partnerships (LLPs) or limited liability companies (LLCs) which serve a similar function.

Caution: Your corporation can lose its limited liability feature under certain circumstances. For instance, if the corporation acts in bad faith, fails to observe corporate formalities (e.g., organizational meetings), has its assets drained (e.g., unreasonably high salaries paid to shareholder-employees), is inadequately funded, or has its funds commingled with shareholders' funds, its corporate veil might be pierced.

Offers centralized management

A PC has centralized management through its board of directors. Shareholders not on the board indirectly participate in management by electing the board of directors and voting on certain corporate issues.
**Possesses continuity of life**

A PC, whether in the form of a C or S corporation, can exist forever. It can continue to "live" after an owner's death, bankruptcy, retirement, disability, expulsion, or resignation. In contrast, a partnership ordinarily dissolves when one partner dies or otherwise withdraws from the business.

**Caution:** If the shares of a deceased, bankrupt, or disabled shareholder do not pass to an eligible shareholder (a member of the profession), however, your business will not be able to continue as a PC (or as a corporation at all, for that matter) without reincorporating the business.

**Provides tax advantages**

Incorporated professionals, unlike their counterparts in partnerships or sole proprietorships, get tax advantages through their eligibility for company employee benefit plans if the PC is taxed as a C corporation. In contrast, those in partnerships and sole proprietorships are considered self-employed and thus ineligible. See discussion below under Tax Considerations. As a general rule, moreover, corporations face more straightforward accounting and tax rules than partnerships.

**May add prestige and credibility for marketing purposes**

Adding "PC" to the end of your business name may add a small measure of prestige and credibility to your professional practice. You might attract a few additional clients or patients as a result.

**Tradeoffs**

**May be relatively difficult and expensive to form and maintain**

Professional corporations (PCs), whether in the form of C corporations or S corporations, are typically more difficult and expensive to form and maintain than partnerships or sole proprietorships. You may be required to file articles of incorporation or similar documents with the state, adopt by-laws, elect a board of directors, and hold regular board of directors meetings. You may need to pay an initial filing fee and annual fees, as well as initial and subsequent attorney's fees.

**Restrictions on ownership**

Under state law, only certain professions are eligible to form PCs. The eligible professions often correspond closely with those professions subject to state licensure. Check your state's law to find out which specific professions are eligible. In addition, you face restrictions on incorporating with members of different professions.

**Restrictions on transferability of interests**

A shareholder of a PC generally can only transfer stock to another member of the same profession. An engineer, therefore, cannot transfer shares to a physician.

**Loss of some autonomy and individual identity in accounting, billing, record keeping, and other matters**

In exchange for the convenience of turning over management details to a board of directors and officers, you, the professional, may sacrifice a degree of autonomy. Records, billing, and accounting will typically be in the corporation's name, not yours. For example, physicians must accept that the corporation may bill their individual patients and take out malpractice insurance policies for them.

**How to do it**

**Consult an attorney**

You should consult an attorney experienced in business planning. The attorney should know your state’s laws prescribing the basic requirements for incorporating in general and as a professional corporation (PC) in particular.
Deliver articles of incorporation to secretary of state

Generally, to create a PC, you must file articles of incorporation with your secretary of state or other designated state department. State law will dictate what you will need to include in this document. Your state may charge a filing fee.

Adopt corporate by-laws and elect a board of directors

You must also adopt by-laws, have your shareholders elect a board of directors, and hold your first organizational meeting.

Choose a corporate name

When deciding on a corporate name, you need to address the issues of whether the name is already in use. First, you want to check your secretary of state’s office to make sure another corporation is not already using your proposed name. Second, you want to be certain that the name doesn’t violate another business’s federally registered trademark or service mark. Consult a qualified corporate or trademark attorney for assistance with these naming and trademark issues.

Make your entity classification election

Under the Internal Revenue Code, a PC has the option of electing S corporation status if it meets certain requirements. If you wish to choose “S” status, you need to make an election on IRS Form 2553. Otherwise, the IRS will consider your business a C corporation.

Restrict the transferability of interests

Since shareholders must be members of an eligible profession, the transfer of stock to an ineligible shareholder will result in loss of your corporation status. (Note that if you have also elected “S” status, you face additional restrictions on transfers of stock.) You should consider using an appropriate buy-sell agreement.

*Checklist is not exhaustive

Tax considerations

Income Tax

Incorporated professionals can take part in tax-favored employee benefit plans

If you organize as a professional corporation (PC) and are taxed as a C corporation, you may be able to take advantage of tax-favored employee benefit plans unavailable to owners of partnerships and sole proprietorships, such as:

- Group term life insurance
- Group medical insurance
- Reimbursement for medical expenses
- Disability benefits
- Deferred compensation

Both you and the corporation may realize tax benefits. Consult a qualified tax advisor or attorney for specific advice and information.
Choosing C or S corporation status has substantial tax implications

C corporations and S corporations face fundamentally different tax treatments. C corporation profits are subject to a double tax: once when earned by the corporation and again when distributed to shareholders as a dividend. S corporation profits are taxed only once, when distributed to shareholders.

Caution: Several pieces of legislation have mitigated at least some of the double taxation burden of a C corporation. These laws provide that dividends received by an individual shareholder from domestic corporations (and qualified foreign corporations) are taxed at lower long-term capital gains tax rates. Most recently, in general, the American Taxpayer Relief Act of 2012 permanently extended the preferential income tax treatment of qualified dividends and capital gains. Capital gains and qualified dividends are generally taxed at 0% for taxpayers in the 10% and 15% tax brackets, and at 15% for taxpayers in the 25% to 35% tax brackets. However, starting in 2013, dividends and capital gains are generally taxed at 20% for taxpayers in the new 39.6% tax bracket for high-income taxpayers. Also, as a result of the Affordable Care Act of 2010, beginning in 2013, an additional 3.8% Medicare tax applies to some or all of the investment income for married filers whose modified adjusted gross income exceeds $250,000 and single filers whose modified adjusted gross income is above $200,000.

Be aware of potential personal service corporation and personal holding company tax issues

PCs occasionally run into federal tax issues involving personal service corporation tax and the personal holding company tax. The IRS considers most PCs to be personal service corporations (PSCs) because a significant percentage of their revenue comes from providing personal services. There are special tax rules for PSCs of which you should be aware. PCs with relatively few shareholders must also be aware of the personal holding company tax. The IRS imposes this 15 percent penalty tax on undistributed income of personal holding companies. PCs, particularly smaller ones, run the risk of being considered personal holding companies. Consult a tax specialist or attorney for further information and advice on avoiding the personal holding company tax as well as the personal service corporation tax.

Incorporating an existing professional practice has tax ramifications

Transferring assets from an existing professional sole proprietorship or partnership raises tax issues. With the assistance of an attorney, you may be able to structure a tax-free exchange of assets for stock. You may have reason, though, to prefer a taxable transfer that offers the corporation a step-up in basis and favorable depreciation deductions. Discuss these matters with your tax advisor and/or attorney.