

Ownership (Self-Employment)

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No physician, insofar as he is a physician, considers his own good in what he prescribes, but the good of his patient; for the true physician is also a ruler having the human body as subject, and is not a mere moneymaker.

Plato, *The Republic*

The practice of optometry is a business, just as the practice of medicine is a business, and the successful conduct of a business relies on the generation of profit. The profit motive is a necessary aspect of practice; without it, the undertaking becomes one that is more properly termed a hobby. Optometrists must regard their profession as a business enterprise for which the production of a profit is a desired and necessary result.

As Plato points out, however, there are unique characteristics that elevate a health care professional above the level of “mere moneymaker.” First, the product of a profession is the skill and judgment of its practitioners. An optometrist provides services (just as a physician), and although an optometrist also provides materials, these are incidental to the services (in the same fashion that crutches are incidental to the services of an orthopedist).

A second consideration involves the relationship between an optometrist and the optometrist’s patients, which—because of the specialized learning of the optometrist and its relationship to patients’ health—requires the optometrist to adhere to certain ethical and legal standards and to divulge findings fully. Although spectacles and contact lenses are products that are sold in the course of business, when handled by an optometrist incidental to the performance of professional services, the transaction becomes one quite apart from the mere sale of merchandise. Consequently, the motto of the marketplace—*caveat emptor* (“let the buyer beware”)—has no application to optometry.

A third characteristic of the professional nature of optometry concerns the requirement that nothing be permitted to interfere with an optometrist’s obligation to his or her patients. This problem most commonly involves the employment of optometrists by businesses that rely on the sale of ophthalmic goods and materials for profit. The need to sell goods can intrude on the optometrist-patient relationship, adversely affecting the ability of the optometrist to exercise an independent judgment (i.e., one in the patient’s welfare rather than for the benefit of the business). Numerous legal decisions have cited this problem as

justification for upholding statutes prohibiting the practice of optometry by for-profit corporations.

Even so, optometrists confront numerous legal and tax requirements incidental to the conduct of a business. For selfemployed optometrists, the most important consideration in this regard is the type of business organization the optometrist chooses for the delivery of services. For a private practitioner this decision will have significant ramifications affecting the income the optometrist will earn, the amount of time that must be devoted to the complexities of the business, the optometrist’s exposure to liability issues, the tax accounting and reporting that must be performed, and even the choices available to the optometrist for retirement planning.

Self-employed practitioners frequently choose to practice as a limited liability company (LLC) in states allowing such an entity for health care providers or as a subchapter S corporation. Other types of business organizations used include individual proprietorship, general partnership, and professional association or corporation (PA or PC). Although onepractitioner PAs or PCs, S corporations, and LLCs may be permitted, these types of business organizations are customarily used to form partnerships. An individual proprietorship is the only type of business organization that is limited to one owner.

The majority of optometrists in private practice are selfemployed (see Chapter 1). Surveys conducted in the past 2 decades by the Association of Practice Management Educators (APME) have revealed that approximately 60% of graduates enter private practice as employees, approximately 30% are self-employed and the remaining 10% enter residencies. These same surveys have shown that most graduates who enter employee positions immediately after graduation intend to become self-employed eventually.

This chapter discusses the advantages and disadvantages of entering various types of ownership/self-employment—as a sole proprietor, general partner, member of a limited liability company, shareholder in a subchapter S corporation, or shareholder in a PA or PC. It also describes expense sharing. Employment opportunities are described in Chapter 4.

INDIVIDUAL (SOLE) PROPRIETORSHIP

Individual (sole) proprietorship is the choice of about 10% of optometry school graduates. Although 32% of optometrists are in practice by themselves, a small minority are organized as individual proprietors. A sole proprietor owns 100% of the practice, even if other optometrists work for the practice as employees or independent practitioners (independent contractors). To enter into sole proprietorship, an optometrist either starts a new practice or purchases an existing one.

Starting a Practice

The decision to start a practice requires extensive planning. Usually, the greatest drawback to starting a practice is financial. Most optometrists have significant student loans and consumer debt whether they are new graduates or seasoned optometrists and the added debt of opening a new office may prevent such an undertaking from being financially feasible. The optometrist must carefully evaluate income and expense projections for the practice, with emphasis on keeping fixed overhead expenses to a minimum. Projections for income should be conservative. When starting a practice “cold,” it is usually necessary to have outside sources of income from other employment opportunities.

In addition, a new business owner needs to learn and develop excellent business and management skills. It will be helpful to obtain additional education in these areas. Courses in business management and law, financial management, and marketing are particularly useful. Developing a team of advisors, including a skilled certified public accountant (CPA) familiar with optometry, an attorney, real estate and insurance agents, and a banker, is essential.

Another key factor in starting a practice is finding the right location. An excellent location can mean more than an increase in earnings; it can be the difference between success and failure (location is discussed in Chapter 10). If an optometrist is willing to accept the responsibility of managing a business and can overcome the financial risks involved, the pride, rewards, and satisfaction of watching a practice grow and mature can be extremely gratifying. This new business owner must be willing to forego immediate financial returns for the long-term benefits that self-employment provides.

In financial terms, however, the rewards are much better for self-employed optometrists than for employed practitioners. The American Optometric Association (AOA) Economic Surveys (see Chapter 1) show that higher levels of income are reported by self-employed optometrists. When starting a new practice, however, an 8- to 10-year period is needed to achieve mean income levels. Once the practice has been established, it can sustain the practitioner for 30 or even 40 years. Often, a sole practitioner will take on employees or decide to form a partnership, which further increases the size of the practice. Because of the autonomy enjoyed by sole proprietors, there is considerable flexibility in this form of practice.

Purchasing a Practice

The purchase of an existing practice can be a better choice than starting a new practice. An established office will have equipment, patient flow, staff, and procedures already in place. Financial planning is much easier because the practice has an established gross income, overhead expenses, and cash flow. Determining the fair value of the practice is usually the most difficult aspect of the purchase agreement and is discussed in Chapter 8.

To pay for the practice, a loan can be taken from a financial institution or the seller can self-finance the purchase. In either event, the purchaser must pay for the practice, with interest, for a period of years. Such an arrangement can be financially advantageous, however, compared to starting a new practice. The sole proprietor can often do better financially during the 5 to 10 years of repayment than if a new practice is started. Again, financial and legal advice will be needed to determine whether the arrangement is a fair one, to allocate the practice assets for tax purposes, and to draft the contract of sale. Box 3-1 summarizes the major advantages and disadvantages of a sole proprietorship.

Organization

The business entity does not have to be registered with the state, and there is no paperwork that must be filed to form the proprietorship. Provider numbers and tax identification numbers are needed to bill for third-party services and to pay income and other taxes, but they are not required to form the individual proprietorship.

Liability

Issues The individual proprietor is legally responsible for the conduct of the practice. There are two key areas in which this legal responsibility can be applied: contractual obligations and injuries to others.

BOX 3-1

Advantages and Disadvantages of Sole Proprietorship

ADVANTAGES

- One person rule, with control over decisions and destiny
- Higher long-term income potential and greater equity potential
- Independence, control of the office schedule, time off, vacations, and similar matters
- Choice of optometric specialties to be practiced

DISADVANTAGES

- The pressure of all decisions, management, and marketing responsibilities rests on the shoulders of the practitioner
- Multiple financial risks and competitive challenges
- Lower starting income, higher start-up costs
- Lack of office coverage in the event of illness, vacation, and time off
- Fewer specialties to offer

Contractual Obligations

The proprietor will customarily be the person authorized to negotiate and ratify contracts for the business, although this responsibility may be delegated to another person by creating a principal and agent relationship. Any contracts entered into by the proprietor or the agent for the benefit of the business becomes the personal responsibility of the proprietor, thus the proprietor's personal assets (including the assets used in the business) are at risk. The reason for this personal liability is that the proprietor typically signs such contracts as an individual, and in the event of default, the injured party may proceed against the proprietor for damages. If damages are awarded, they will be taken from the assets of the proprietor (if not covered by insurance).

Unlike partnerships and corporations, which may own assets in their own name, the title to property in an individual proprietorship must be held by a person or entity other than the proprietorship. Thus, among the basic types of business organizations, individual proprietorships create the most exposure to personal liability. However, insurance may be obtained that provides indemnification in the event of legal claims.

Injuries to Patients and Others

The law relating to personal injury is complex but generally states that the responsibility for injury in an individual proprietorship falls on the shoulders of the proprietor. If a person is injured on a proprietor's premises or is injured by a proprietor's act (or failure to act) and there is legal fault on the proprietor's part, then the proprietor may be held solely liable for the injury and consequent damages. Under certain circumstances, the proprietor may be legally responsible for the conduct of employees such as when the conduct results in injury to a person by an employee who is acting in the line and scope of his or her duties. This responsibility results from the legal relationship of employer and employee and applies to employee optometrists, opticians, assistants, technicians, and receptionists.

Thus the liability of sole proprietors is not limited to their own acts but also can result from the acts of others performing duties on their behalf. For this reason, appropriate professional liability insurance is a necessity.

Tax Considerations

Tax reporting is the principal form of regulation to which the individual proprietor is subject. The two basic types of tax reporting that must be observed in a sole proprietorship are reporting related to the financial status of the business and reporting related to the financial status of the individual proprietor.

Business Taxation

There are federal, state, and local tax requirements that must be observed by individual proprietorships. The profit or loss of the practice is calculated on Schedule C, and this amount is then entered on the individual proprietor's Form 1040 (see Chapter 39). Schedule C, however, is not the only federal tax form required of an individual proprietor; periodically a proprietor must remit taxes for Social Security, Medicare, and unemployment insurance and for federal income tax withholding, including self-employment taxes (see Chapter 39).

In addition to these obligations, the individual proprietor must comply with state and local (county, city) tax withholding requirements. As a result, the individual proprietor faces a constant succession of tax deadlines that must be met or penalties will be incurred.

Individual Taxation

The income tax obligations of the proprietor are intimately tied to the profit or loss earned by the business. Although there are exemptions, personal deductions (calculated on Schedule A), and credits that affect the tax to be paid, the income earned from business exerts the greatest effect on taxation. This also is true for Social Security and Medicare taxes, which are based on the income reported on Schedule C. Individual proprietors must remit taxes periodically for income, Social Security, and Medicare to the federal government or face severe penalties for failing to do so on a timely basis. A calendar that outlines the customary deadlines for tax reporting can be found in Chapter 39.

GENERAL PARTNERSHIP

A partnership may be legally defined as "an association of two or more persons to carry on as co-owners in a business for profit." From this description, it is apparent that there are the following three necessary requirements for the formulation of a partnership:

- Two or more "persons"
- Co-ownership among these persons
- The intent to earn a profit through a mutual undertaking

Thus a partnership is an aggregate of persons rather than a separate entity. The reason for this can be found in law, which requires that partners be sued separately, as persons, rather than jointly as a partnership. Statutory law has managed to convert the status of partnerships into quasi-entities, capable of holding title to property and enjoying certain other property rights but remaining a nonentity for tax purposes and for the purposes of litigation. In fact, statutes have been adopted in all jurisdictions except Louisiana to establish the legal rights of partners and partnerships, and because the law is uniform from state to state, the statute is referred to as the Uniform Partnership Act (UPA).

Although the UPA sets forth in detail the rights and responsibilities of partners, many of these provisions are qualified by the phrase "unless otherwise agreed," which permits the partners to determine the conduct of many of the partnership's internal matters. These agreements are best committed to writing. Consequently, the rights and duties of the parties are defined in a written instrument known as the articles of partnership, or the partnership agreement.

Even though partners turn to attorneys, accountants, or other advisors for guidance in determining the provisions of a partnership agreement, it should be realized that there is no standard partnership agreement that will be acceptable to everyone. Partnership details that have worked for one set of practitioners may be inappropriate for another group because of differences in personalities, professional philosophies, and

BOX 3-2

Advantages and Disadvantages of Partnerships

ADVANTAGES

- Generally higher earnings than solo optometrists
- Shared overhead, less capital outlay per partner compared to solo optometrists
- Office coverage during vacations, illness, and personal holidays
- Consultation with partner for business and patient management decisions
- Expanded hours, convenience for patients
- Investment in career protected and equity established for retirement, disability, or death

DISADVANTAGES

- Loss of independence
- Personality conflicts with partners or the spouses of partners
- Differences in professional ideas and philosophies
- Unequal distribution of patient load
- Unequal distribution of income based on productivity of the partners

perhaps economic needs. When a partnership agreement is being contemplated, individuality of effort will be an important factor, and the prospective partners should realize that they need to formulate their partnership agreement so that it is custom-made for them (Box 3-2).

Optometrists who are contemplating entering into partnership should take the time to discuss at length their partnership plans to ensure that they are compatible. A thorough discussion may ward off a union that is preordained to failure, thus avoiding the heavy financial and emotional costs of a subsequent split-up. Disagreements between partners may be resolved by the UPA, which is applied in the event the partnership agreement is silent or unclear or unenforceable. For this reason, the task of drafting the partnership agreement should be left to a knowledgeable attorney.

Organization

To form a partnership, once a name is chosen a search should be conducted (on the Internet at the local county clerk, or with the secretary of state) to ensure that there is no other business entity using the same name. If there is no conflict with the partnership name, it should be registered with the county clerk in the county where the business is located, or with the Secretary of State.

The operation of the partnership should be described in writing in the business' articles of partnership (or partnership agreement), signed by the partners, and retained for use by the business.

Liability of Partners

Because of their legal status as associations of individuals, partnerships have some unique legal provisions that need to be understood by prospective partners. The most important

considerations involve liability issues and the tax ramifications of partnership.

Partners are individually responsible for their conduct and collectively responsible for the conduct of employees. Because each partner is considered the agent and partner of the other partners, however, partners have a responsibility for one another as well. This liability is referred to as joint and several liability.

Joint and several liability allows an injured party to sue one or more of the partners separately or all of them together, at the party's option. Thus partners are liable for one another's acts and may be sued individually or collectively, which increases their liability beyond that faced by the sole proprietor. The most likely types of legal actions that partners face are those based on contract and those alleging injury to others.

Contractual Obligations

Because any partner with apparent authority to do so may sign a contract binding the partnership (and thus the other partners) to its provisions, partners need to carefully oversee contractual obligations. One means of limiting the opportunity for misadventure is to require the agreement of all partners whenever expenditure in excess of a certain sum is contemplated. Another time-tested means is to require the signatures of at least two persons on partnership checks.

Injuries to others may result in liability claims; if a partner has been negligent, not only is that partner potentially responsible but also each of the other partners and all partners collectively. Thus all partners may end up as defendants to a lawsuit for damages. If the injured party wins a judgment and is unable to satisfy it by proceeding against the assets of the negligent partner, the law permits the injured party to proceed against the assets of any of the other defendant partners or of the partnership if it was a defendant in the case. To protect against this eventuality, partnerships purchase a special form of professional liability insurance that covers the joint and several liability of partners.

Tax Considerations

A partnership is not a taxable entity, and partnership profits (and other income and gains) are not taxed to the partnership. The partnership must report its income and file Form 1065, US Partnership Return of Income, which provides basic information on partnership income or losses for the year and the partners' distributive shares of that income or loss, which is reported to the partners on Schedule K-1. The partners list this income or loss on their individual Form 1040. Taxes are paid on the income reported and deductions claimed on the Form 1040 by each individual partner (see Chapter 39).

Partnerships are permitted to deduct certain expenses that are ordinary and necessary to the conduct of business. These deductions reduce the distributive share of partnership income that is to be allocated to the partners. They are in effect borne by the partners themselves in a proportional fashion. Income to partners is usually referred to as a draw against profits, paid on a monthly basis and applied at the conclusion of the tax year to the partners' distributive shares of the partnership profit.

Individual partners may claim many of the same tax deductions as individual proprietors; a working knowledge of the basics of tax law is essential.

CORPORATIONS

Corporations composed of professionals have permitted health care providers to enjoy tax advantages synonymous with this form of business enterprise. For a few decades, they were the preferred choice of professionals in all aspects of health care, but PAs or PCs have always enjoyed more popularity in medicine than in optometry. The formalities necessary to form a corporation, the technical obligations required maintaining it, and the complicated financial transactions that must be performed to realize favorable tax advantages have mitigated against widespread acceptance within optometry. Also, federal tax laws have been changed to elevate the tax benefits available to nonincorporated, self-employed practitioners, and when combined with new forms of business organization (such as subchapter S corporations and LLCs), the allure of corporations has decreased.

Characteristics of Corporations

A corporation is an artificial creature of the law that is endowed with certain characteristics. Among the most important is the right of perpetual succession, which allows the corporation to continue despite the withdrawal, disability, or death of those who comprise its ownership or are employed by it to perform services. Unlike individual proprietorships, which end with the retirement or death of the proprietor, and partnerships, which likewise must be dissolved when the partners end their association with one another, corporations may continue for as long as it is profitable for them to do so.

Another important general characteristic of corporations is the separation of ownership and management. In a sole proprietorship the individual owner has sole authority over how the practice is run; in a partnership the same result is obtained because ownership and management are merged in the partners, who direct among themselves the conduct of the practice; in a corporation, ownership and management may be separated so that the owners will not have any direct responsibility for or any direct authority over the manner in which the practice is managed. In PAs and PCs, however, this advantage is not fully realized.

Ownership of a corporation is indicated through the purchase of shares of stock. The stock is issued by the corporation for a face value, and its value is set later by the law of supply and demand (i.e., the more profitable the corporation, the more valuable the stock). The stock is freely transferable, although in a PA or PC there are certain restrictions for its sale established by state law. The primary restriction limits ownership of stock in PAs or PCs to certain licensees who are eligible to incorporate. Many states do not permit licensed professionals who are in different disciplines to join together in ownership of a common professional services corporation. In these states, optometrists would be barred by law from forming a PA or PC with ophthalmologists.

Because a corporation is recognized as a separate entity by the law, it possesses several of the rights normally accorded only to persons. Among these rights is the ability to own property in its own name, sue or be sued, and claim tax advantages that are separate and apart from those accorded to individuals. This status as an artificial being is one of the most meaningful characteristics of a corporation.

Liability for the debts of the corporation is limited to the corporation itself. If the corporation defaults on a loan, the creditor must proceed against the assets owned by the corporation and not against the assets of the stockholders or employees of the corporation. If the corporation enters into bankruptcy, the owners of the corporation are not responsible for more than their respective shares of ownership, which means that their personal assets cannot be invaded to satisfy the indebtedness of the corporation.

The tax advantages available to corporations have traditionally been cited as the primary reason for professionals to incorporate. The sheltering of income through pension and profit-sharing plans, the purchase of life and health insurance through the corporation, the more effective management of business-related expenses, and the use of voluntary death benefit plans are all distinguishing features of incorporated practice. However, the tax advantages held by corporations have been significantly reduced by changes in federal tax law (see Chapter 39).

Organization

Although the original laws recognizing PAs and PCs required two or three persons to form the corporation, states today permit one person to serve as the incorporator, thus making it possible for an individual proprietor to incorporate. To establish a PA or PC, certain legal formalities must be observed, which are set out in the state code. Typically, a set of documents known as the articles of association or articles of incorporation must be filed with the office of the Secretary of State in the state capital. These articles describe the type of profession that is to be practiced, list the names and addresses of the stockholders of the corporation or association (and of the officers in some states), contain an averral that all incorporators are licensed to practice the profession in the state, and identify the regulatory board to which the incorporators are subject. A fee is charged for filing the papers. This is only the start of the formation process (Box 3-3).

One key consideration when forming a corporation is the use of a trade name (e.g., "See Clearly Eye Center"). The right to use a trade name is regulated by state statute, and states may lawfully prohibit the use of trade names by optometrists. When a trade name is used, it is usually necessary for the name of the practitioners (or practitioner) to be listed with it. This requirement is intended to put the public on notice as to the identity of the practitioner performing services under the guise of a trade name. Failure to observe the legal requirements established by state law for use of a trade name can subject the optometrist to discipline by the state board of optometry.

BOX 3-3

Formation of a Professional Association or Corporation

- The professional association (PA) or professional corporation (PC) must comply with all state requirements for its formation.
- The PA or PC must secure its own federal and state tax identification numbers.
- The name of the PA or PC must be used on office doors, professional listings, telephone listings, invoices, checks, business cards, and other documents.
- All contracts, leases, deeds, and other legal documents must be signed in the name of the association or corporation.
- Ownership of business assets must be transferred to the PA or PC.
- Insurance policies taken out by the PA or PC must be in its name.
- Bank accounts must be opened for the PA or PC.
- A corporate seal and stock book must be obtained and an issuance of stock made.
- A corporate minute's book must be maintained, and the articles of incorporation, bylaws, and other significant documents kept with it.
- Organizational meetings should be recorded in the minutes book, particularly election of the board of directors and officers, adoption of bylaws, establishment of annual dates for shareholders' and directors' meetings, adoption of employment contracts, determination of salaries for employees, adoption of retirement plans, and similar matters.
- Meetings of the board of directors and shareholders must be held, at least annually.
- Contracts for employment must be adopted and signed by employees.
- Buy-sell agreements for the death, disability, or withdrawal of stockholders must be drafted, adopted, and signed.
- Provisions for the timely payment of federal and state taxes must be made.

PROFESSIONAL ASSOCIATIONS AND CORPORATIONS

Several characteristics distinguish both PAs and PCs (Box 3-4). Although there are technical legal distinctions between the

two, in practical effect there is so little difference that the two terms are used synonymously here. Because the corporation is a separate business entity, those dealing with a corporation must be notified that it is the form of business organization being used. Thus professionals who are incorporated are

BOX 3-4

Characteristics of Professional Associations and Corporations**MODE OF ORGANIZATION**

One or more persons who perform professional services may form a professional association (PA) or professional corporation (PC) to practice a profession. The articles of association or incorporation will describe the profession to be practiced, define the identities of corporate shareholders and directors, and specify that each of the stockholders and directors is duly licensed to practice the profession. PA or PC must be placed after the corporate name, which may have to contain the name of one or more of the shareholders or other designations.

SCOPE OF SERVICES

The association or corporation may be organized only for the purpose of rendering one type of professional service (in many states) and may render its services only through its officers and employees, who shall be duly authorized to render the services.

PROFESSIONAL LIABILITY

Employees of the association or corporation are responsible for any liability arising out of personal services rendered by the employees, but no employee will be personally liable in any tort for any act in which he or she did not personally participate. A director, officer, or employee of a PA or PC will not be liable in contract for any contract executed on behalf of the association or corporation within the limits of his or her actual authority.

RESTRICTIONS ON OWNERSHIP

Only persons licensed to perform the services for which the association or corporation was formed may hold membership interest or be shareholders, and shares of stock in the corporation or membership interests in the association may not be transferred or sold except to persons so licensed. The personal representative or estate of a deceased member or shareholder may continue to hold the deceased individual's share for a reasonable period after death but may not participate in decisions concerning the rendering of personal services. The articles of association or incorporation may contain restrictions on the transfer of shares of membership interests and for the redemption or purchase of the shares or membership interests by the corporation, association, or its owners.

TERMINATION OF EMPLOYMENT

If an officer, shareholder, director, or employee of the association or corporation becomes legally disqualified to render professional services, he or she must sever, within a reasonable period, all employment with or financial interest in the association or corporation. Severance pay or other compensation for past services may be authorized by the association or corporation at termination of employment.

ANNUAL STATEMENTS

The PA or PC may be required to file at the anniversary date of incorporation a statement with the secretary of state that lists the identities of all members, shareholders, directors, officers, and employees.

BOX 3-5

Advantages and Disadvantages of Corporations**ADVANTAGES**

- Because corporations are legally recognized as a separate entity, tax deductions that are not available to individual proprietorships and partnerships may be claimed by corporations.
- Corporations can establish tax-deductible medical expenses reimbursement plans for employees.
- Tax-deductible employee insurance programs can be established by corporations.
- The administrative requirements of corporations centralize management and clearly define decision making.
- Corporations have continuity of existence, and the withdrawal of a shareholder will not affect the continuation of the corporation.
- Transferability of ownership is easily accomplished by the sale of corporate stock.
- Employees can participate in a tax-deferred retirement plan established for their benefit. *

* Tax-deferred employee retirement plans may not be optimal for all employees.

DISADVANTAGES

- The organizational and operational costs of corporations are more expensive than those of any other type of business organization.
- Corporations, because they are a separate entity under law, must pay taxes (unlike sole proprietorships, partnerships, limited liability companies (LLCs), and subchapter S corporations).
- Corporations are subject to the accumulated earnings tax if a corporation keeps (rather than pays out) profits in excess of an amount deemed reasonable for present or future business plans.
- The greater business complexity of corporations makes them more costly and time-consuming to run than other types of business organizations.
- In corporations that consist of more than one person, there is a loss of autonomy in decision making and management is shared.
- Corporations are subject to more disclosure requirements (governmental and private) than are other types of business organizations.

required to place PA or PC (depending on whether the state law authorizes the formation of an association or a corporation) behind the name of their organization.

The decision to form a PA or PC is typically a financial one, based on a determination that the tax and retirement benefits offset the additional cost and management time involved. Tax and legal counsel are needed before making this choice (Box 3-5). The PA or PC must be owned by professional licensees, who hold shares of stock issued to finance the startup of the business.

Ownership of the corporation vests in these shareholders, who must meet to elect a board of directors. The board is responsible for the long-term management of the corporation and not surprisingly is composed of the shareholders. The daily management of the PA or PC is left to the officers, who are elected by the board of directors. In many states the officers and directors do not have to be licensed professionals, although the shareholders (owners) do. If there is only one incorporator, this individual may become the sole director of the corporation, but non-health care professionals can serve as officers. In some states the sole incorporator may be required to be the president of the corporation, but non-health care professionals can serve in the other officer positions. The officers perform the short-term decision making and conduct the scheduled meetings and other formalities necessary to doing business as a corporation.

Because the PA or PC is a separate entity, it may sign contracts in its own name, borrow money, own property, and exercise other rights normally accorded only to persons. In addition, the PA or PC may contract with individuals to provide services. The number one employee of the PA or PC is the licensee, who is paid a salary and awarded benefits under an employment agreement with the PA or PC. Therefore an optometrist who forms a PA or

PC will be its owner, chief officer, and most important employee. In a PA or PC partnership, there will be some proportionate sharing of ownership, duties, and benefits.

PAs and PCs differ from partnerships in terms of their continuity. In partnerships, if a partner dies, the partnership is usually dissolved. In a PA or PC, if a shareholder dies the PA or PC continues because it is a separate legal entity that may be owned by a successor shareholder. To transfer ownership, the successor purchases the shares of stock held by the previous shareholder.

Tax and liability issues are different for corporations than for partnerships. Unlike other types of business organizations, PAs and PCs must pay income taxes, which add to their complexity and cost. The employees of the PA or PC also pay income tax on the salary and benefits received from the PA or PC. Accounting and tax advice are essential.

Liability Issues

There are two types of liability claims that are of significance to incorporated practitioners: those that arise out of a contract and those that are a result of personal injury.

Contractual Claims

Because a PA or PC may contract in its own name, it is customary for officers authorized to execute contracts on behalf of the corporation to do so in their official capacity. The officer's signature binds the corporation, which is solely responsible for any breach or failure to comply with contract terms that result in damages to the contracting party. If damages must be paid, they must come from the assets (or the insurance) held by the corporation. Neither the officers nor the shareholders will be held liable. If the corporation fails, the loss to

the shareholders will be the money invested by them in the business enterprise. Their personal assets will not be vulnerable unless they were obligors as individuals along with the corporation (i.e., signed the contract personally). Thus a corporation affords some protection from contractual liability that an individual proprietorship and a partnership cannot. (Subchapter S corporations and LLCs also provide this type of shelter from contract liability claims.)

Liability Claims

If an employee of a corporation injures a person or property and the employee is held to have been legally at fault, not only is the employee responsible for the resultant damages but the employer also may be held liable if the employee was acting within the line and scope of the employee’s duties at the time of the injury. In this respect, the liability of a corporation is no different from that of any other type of business organization. As with contracts, the liability of the corporation is limited to the extent of its assets. PAs or PCs, however, may purchase liability insurance for indemnification in the event of such claims, and in the usual case the damages are paid by the insurance that is purchased by the corporation for the protection of its employees. If the insurance coverage is adequate to pay the claim, corporate employees are shielded at least to this extent in the incorporated practice. Of course, if the negligent employee is the optometrist in a one-person PA or PC, the optometrist is personally liable and so is the corporation. In an individual proprietorship, the owner optometrist is similarly liable; in a partnership, the partners are liable both individually and as a group (Table 3-1).

Tax Considerations

The PA or PC is treated as a separate tax entity, which results in both advantages and disadvantages. The tax rate for a professional service corporation is considerably more than rates for individual practitioners. Although the federal tax rates for corporations are based on income—ranging from 15% (for net income of up to \$50,000) to 39% (for net income from \$100,000 to \$335,000)—PAs and PCs must pay a flat 35% tax on net income. Since both the corporation and the employee-optometrist are subject to income taxation, it may be considered

disadvantageous that a “double tax” can be imposed on an incorporated practitioner. But the tax deductions permitted to PAs or PCs usually enable taxable income to be reduced to zero or to a minimal amount, so that the PA or PC pays no or little tax, leaving the employee-optometrist’s salary as the major item subject to income taxation.

The distribution of corporate income takes the form of salary (or bonuses) or dividends. Dividends are a distribution of any profit remaining after the costs and expenses of running the corporation have been paid. Since dividends are not tax deductible and the salaries paid to employees are a major deduction for any business, the preferable distribution of corporate income is as a salary. Salaries paid to corporate employees (and particularly to optometrist-owners) must be reasonable; income that is in excess of what is considered reasonable may be treated as a dividend by the Internal Revenue Service (IRS) and may be denied as a deduction for the corporation. Therefore determining the reasonableness of salaries is an important consideration for PAs and PCs.

If the salaries paid by the corporation have reached the maximum level of reasonableness, it may not be feasible to distribute further income. In this event the profits may be retained in the corporation. To prevent using the corporation as a shield against taxation, the IRS imposes an accumulated earnings tax, which is 34%. This serves as an incentive to use earnings to purchase benefits for employees or for tax-deferred retirement plans.

Corporations must file a tax return even if the corporation has no taxable income. The federal income tax form for corporations is Form 1120 (US Corporation Income Tax Return). Corporations also are required to make estimated payments of income and Social Security tax. Estimated tax payments must be deposited with an authorized depository of a Federal Reserve Bank. The due date of deposits and the number of installments depend on the earnings of the corporation (see Chapter 39).

Employees of a corporation are paid a salary, and the corporation is responsible for the proper withholding of taxes. Employees will receive an annual summary of salary and withholding on the W-2 form issued by the corporation. The employee reports this income on the employee’s Form 1040 and attaches the W-2 to it.

TABLE 3-1

Liabilities of Business Organizations

	Individual Proprietorship	Partnerships	LLCs	PAs or PCs	S Corporations
Contracts	Optometrist is liable.	Partners are jointly liable.	LLC is liable.	PA or PC is liable.	S corporation is liable.
Negligence by the optometrist	Optometrist is liable.	Partners are jointly liable.	LLC is liable.	PA or PC is liable.	S corporation is liable.
Negligence by a Nonoptometrist employee	Optometrist is liable.	Partners are jointly liable.	LLC is liable.	PA or PC is liable.	S corporation is liable.

SUBCHAPTER S CORPORATIONS

Subchapter S corporations represent a hybrid form of business organization, melding together the advantages of partnerships and corporations, while eliminating their weaknesses. Like a corporation, ownership is vested in shareholders who have contributed capital to start the business and who receive shares of ownership in return. But the limits on ownership found in PAs and PCs are eliminated, allowing ownership to be more readily transferred. It is the preferred type of business entity for an optical shop because optometrists, opticians, and laypersons can share ownership. (However, some states like California preclude such financial relationships between optometrists and opticians.)

Organization The process for filing articles of incorporation to establish a corporation must be completed, then subchapter S status may be elected (within a stated number of days) after formation of the corporation. The election to obtain S corporation status is far more popular than the formation of PAs and PCs. This decision is primarily motivated by a desire to escape the double taxation found in the corporate earnings structure. S corporations pay no income tax, like a partnership or LLC. However, the S corporation is still entitled to corporate tax benefits such as contributions to retirement plans, premiums paid for insurance coverage, and other tax-deductible items used by PAs or PCs.

The S corporation also enjoys other advantages, including elimination of the problem of accumulated earnings tax, the controversy over whether compensation to employees is a salary or a dividend, and the difficulty of determining whether compensation is reasonable.

To elect subchapter S status, a corporation must meet certain requirements. The most important are the following:

- The election must be unanimous among the shareholders.
- The election must be made during the first month of the tax year (or in the month preceding).
- There must be no more than 100 shareholders; partnerships or corporations cannot serve as shareholders.
- No more than 25% of corporate income can be passive investment income (e.g., from royalties, rents, or dividends).

One major problem with these corporations has been the technical requirements necessary to maintain subchapter S status, which, if lost through some unintended act, can have consequential and undesirable tax ramifications for shareholders. Compliance with state and IRS requirements is essential for this reason.

Optometrists who have formed S corporations may participate in tax-deferred retirement plans, such as 401(k) plans, or Keogh-defined benefit or defined contribution plans and thus may enjoy the same tax advantages as other self-employed optometrists. In some circumstances, these business entities may provide an advantage such as when used as the form of business for an

optical dispensary. The shareholders do not have to be licensees (as in a PA or PC), and an optometrist may share ownership with another professional (such as an optician) or nonprofessional (such as a spouse). The decision to qualify for subchapter S status is one that should be made only after careful discussion with a tax advisor and attorney. Once formed, care should be taken to comply with the technical requirements necessary to maintain an S corporation.

Liability Issues

A primary reason for the creation of S corporations was to shield owners from legal responsibility for contractual and liability issues. Shareholders are not liable for legal responsibilities of the S corporation because the corporation is an artificial entity under law that may sign contracts, undertake financial obligations, and incur responsibility for the acts or omissions of its employees.

Contractual Issues

If an officer or agent of the S corporation signs a contract in an official capacity, the officer or agent cannot be held individually responsible for the contract. Similarly, only the resources of the S corporation may be used to satisfy a judgment or settlement. The personal resources of shareholders are separate from those of the S corporation and cannot be used for the repayment of contracts, debts, or other financial indebtedness of the S corporation.

Liability Issues

Because the S corporation is the employer of its optometrists and other employees, any acts of negligence or other causes of personal or financial injury incidental to the care of patients are the legal responsibility of the S corporation. Shareholders may not be held liable for judgments or settlements resulting from liability claims. The only exception to this protection from liability occurs when a shareholder-optometrist causes injury; as the tortfeasor the optometrist may be held individually liable for damages, and the employer S corporation may also be held liable under vicarious liability law.

Tax Considerations

The use of an S corporation allows ownership to be shared by laypersons (such as opticians, business people, or spouses), and—unlike PAs and PCs—the S corporation pays no income tax, being treated for tax purposes like a partnership. The S corporation files a Form 1120S, US Income Tax Return for an S Corporation, which reports the income received and expenses of operation paid by the S corporation. The income (or loss) is divided by the shareholders, who pay taxes on their distributive shares of earnings. (Income paid to shareholders is reported on Schedule K-1.) Even though the S corporation pays no taxes, it may still claim certain tax benefits such as contributions to retirement plans, premiums paid for insurance coverage, and other tax deductions that may otherwise be claimed only by PAs and PCs.

Another tax advantage may be realized through the payment of dividends. If there is profit after the salaries of employees and the expenses of running the S corporation have been paid, these profits may be paid to the shareholders as dividends. Because they are not wages, dividends incur no Social Security/Medicare taxation, which results in a 15.3% savings on dividend income. When income is paid out as dividends, the salaries awarded to employees of the S corporation must be reasonable and not artificially low so as to reduce taxes by maximizing dividends.

Because of federal and state legal requirements, the advice and assistance of a CPA and an attorney will be required when an S corporation is being formed and maintained.

LIMITED LIABILITY COMPANIES

In the 1990s a hybrid form of a nonincorporated business organization was recognized, blending together key advantages of both corporations and partnerships. Although first intended to be an alternative to partnership, one-person LLCs have now been authorized in all states; although in some states like California LLCs are not permitted for health care providers. The formalities for organization and administration of LLCs are less than those for incorporated forms of business but distinctly more than the formalities required for individual proprietorships. Like sole proprietorships and subchapter S corporations, LLCs are not taxed as business entities, and they also provide protection from liability, although this benefit is not fully realized in one-optometrist LLCs. Primarily, they offer an alternative to subchapter S corporations because they provide the same tax advantages without incurring the administrative demands of a corporation.

Organization

A business name must be chosen for the LLC. Because it must not be the same name that is used by another LLC within the state, the Internet the clerk of the county in which the LLC is located, and the Secretary of State should be consulted before the name is chosen. The name must be registered with the county or state (depending on state law), and articles of organization must be filed. A filing fee is charged, with the amount varying from state to state. Besides the LLC's name, the articles of organization must include the name and address of the registered agent for the LLC, the LLC's legal address, its business purpose, the organizer filing the paperwork, the members (owners), and whether the LLC will continue after the withdrawal of any member.

Although an LLC must have articles of organization, it is not required by law to have an operating agreement. Even so, an operating agreement is clearly needed to clarify issues related to the organization and administration of the LLC and to ensure that the members understand and agree to the many issues related to the conduct of the business. This document resembles a partnership agreement in that it describes the ownership interests of the members; how profits and loss are to be allocated; the management of the LLC; the voting interests of the

members; the sale or other transfer of members' interests due to withdrawal, disability, or death; rules for meetings and administrative decisions; and other important management issues. Such organizational structure is necessary because state laws that regulate the administration of LLCs (the state's Limited Liability Company Act) do not cover the many types of details that are part of the regulation of partnerships under the UPA.

Special provisions may describe the administrative responsibilities of members and the transferability of members' ownership to successors (these rules are similar to the rules for PAs or PCs because only professional licensees would be legally eligible to hold an ownership right in the LLC).

Because the organization and administration of an LLC are less formal than those of a corporation, periodic board meetings, minutes, and other formalities of operating as a corporation are not required of an LLC. However, the members of the LLC may elect managers to run the business entity in the same manner as the directors of a PA or PC are elected by the shareholders to run the PA or PC. The members also may choose to operate like a partnership, with each owner having an equal say in the management of the practice.

Liability Issues

LLCs provide a shield from liability similar to the protection afforded by S corporations. Owners of the LLC are not liable as individuals for the debts or negligence of the LLC or for the debts or negligence of other members. These features are the reason that LLCs are preferred over general partnerships. The owners in an LLC have limited rather than joint and several liability, as in a partnership. This protection from liability in an LLC is akin to that of a PA or PC: the business entity is responsible for liability issues, such as contract or negligence claims, rather than the owners of the LLC. For example, if a member (owner) of an LLC is negligent, the legal claim will involve the member and the LLC but not the other members. In one-member LLCs, this protection may not be realized because the optometrist-member may be required to sign contracts in an individual capacity or be the one who caused negligent injury.

Tax Considerations

In a one-member LLC, the business organization pays no tax and the determination of profit or loss is calculated on the member's Schedule C, which is attached to Form 1040. A multiple-member LLC is treated the same as a partnership: the business entity pays no tax and merely reports income and expenses on Form 1065, just as a partnership does. The LLC's profits are allocated to the owners, with each member receiving a Schedule K-1, which shows the income to be reported on that individual's Form 1040. Because there is no tax paid by the LLC business entity (unlike PAs or PCs), the so-called double taxation of both the business entity and the owner-employees is avoided. Even though the business entity in a multiple-member LLC is treated as a partnership by the IRS, the LLC may elect to

be treated as a corporation. Form 8832 must be completed and submitted to the IRS, with the corporate income tax treatment box checked. Because the formation of LLCs is controlled by state law, legal counsel will be needed to ensure that the LLC paperwork has been properly drafted and filed.

EXPENSE SHARING

In an expense-sharing or shared-expense agreement, two or more optometrists share a common location and the expenses of the practice in a manner proportionate to their usage. Each optometrist has a separate patient base, financial and patient records, and some equipment and instruments. In an expensesharing arrangement, the practitioners do not share in profits the way they would in a partnership, and they have separate bookkeeping systems to chart income. Certain expenses are shared, however, in some proportion agreed on by the optometrists. These expenses typically include rent, utilities, repair and maintenance costs, supplies, lease payments on shared equipment, insurance, and the salaries of common employees.

This arrangement falls short of partnership because neither practitioner has any ownership interest in the practice of the other. Instead, it consists of two independent businesses that have found it advantageous to share certain common expenses. The basic requirements of expense sharing are listed in Box 3-6.

BOX 3-6

Basic Requirements for Expense Sharing

- Each practitioner is an individual proprietor.
- Overhead expenses, such as the office lease, utilities, salaries of employees, insurance, and other necessary expenditures, are shared on a pro-rata basis.
- Ownerships of equipment and furnishings is usually separate, although certain items may be purchased and owned jointly.
- A joint bank account is established for the payment of joint expenses, and each practitioner is required periodically to contribute a certain sum to the account; individual contributions are usually a stated percentage of each practitioner's gross income.
- Records are separate and remain the property of the individual practitioners.
- Payment on accounts, collections, and accounts receivable are independently maintained.
- Personnel are usually jointly supervised, but a sole personnel manager can be designated by the practitioners if they so desire.
- A maximum sum is commonly stipulated for joint obligations unless both practitioners agree to the expenditure in advance.
- Adequate liability insurance is required of all practitioners.
- Arrangements may be made for coverage during absences, including compensation to be awarded for such coverage.
- Certain ethical standards or membership in certain professional organizations may be required of all practitioners.
- Some provision for termination of the arrangement with adequate notice will be included in the agreement.

In creating such a relationship, there are certain legal and administrative matters that must be considered. The most important of these involve the formal agreement between the expense-sharing proprietors. An expensesharing arrangement requires a carefully drafted contract that reflects the agreement of the parties. Such a document is best prepared by an attorney. Key clauses within the contract are those describing the manner in which expenses are to be shared; how and what payments are to be made out of the joint account; how large, nonroutine expenditures are to be managed; the procedure to be used in the event the agreement is to be terminated; and a mandatory requirement that a periodic review of the arrangement will be conducted by the parties.

An expense-sharing arrangement may involve another optometrist or occasionally, another type of health care provider (e.g., dentist, podiatrist, or chiropractor). This type of agreement is entered into when individual practitioners believe that the economic benefits make such an arrangement worthwhile. Box 3-7 lists the advantages and disadvantages of expense sharing.

BOX 3-6

Advantages and Disadvantages of Expense Sharing

ADVANTAGES

- Decreased overhead per optometrist compared to solo optometrists. With reduced overhead per optometrist, more financial resources are available for equipment and instrument purchases and other assets.
- Possibly some coverage can be obtained for patients in cases of emergency or vacation, although joint coverage is not required and must be agreed on by the practitioners.
- Consultation and referral to the other optometrist may be available if the optometrist has a different area of interest or specialty.
- Each optometrist maintains a separate practice and controls individual policies, decisions, and management.

DISADVANTAGES

- Coverage of patients by the other practitioner is not required in the event of illness, disability, and vacations and must be agreed on beforehand.
- No value is established for the practice, and there is no built-in buyer as in a partnership or corporation.
- Unlike a partnership or professional association or corporation, profits are not shared.
- Conflicts over scheduling may occur when using a common receptionist.
- Shared expenses must be divided in a fair and reasonable manner, or conflict will occur.
- Decisions about furnishings, improvements, salaries, and other matters may be sources of disagreement.
- Personnel must be shared on an equal or fair basis, or problems can result.

Liability

Issues Because an expense-sharing arrangement falls short of a partnership and consists of two independent businesses that have found it advantageous to share certain common expenses, liability is shared, usually as follows: injuries to patients that occur in individual areas of the office (e.g., examining rooms) are the responsibility of the individual practitioner occupying that space and injuries that occur in shared areas (e.g., waiting room) are a joint responsibility. Liability for the acts or omissions of an assistant depends on for whom the assistant was working at the time the injury occurred. Legal responsibility for contractual obligations is similar: contracts entered into by an individual proprietor are the responsibility of the individual, and joint contracts are the responsibility of all who have entered into them. Liability insurance should be purchased to provide protection against legal claims arising out of shared premises.

Tax Considerations

In expense sharing, each optometrist files a separate tax return, and the calculation of business-related expenses (including the shared costs of operations) is performed by each practitioner independently. Careful accounting of expenses will be required

to ensure that proportionate deductions for expenses, as agreed to by the proprietors, are made.

CONCLUSION

Self-employed forms of doing business offer the most longterm opportunity, flexibility, security, and financial return for optometrists (Table 3-2). They also require the most effort, investment, commitment, and risk. Hybrid forms of doing business—S corporations and LLCs—offer reasonable protection from liability claims and significant tax advantages, which is why they are popular business entities chosen by optometrists and other types of health care providers.

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TABLE 3-2

Differences Between Practice Arrangements

	Partnership, LLC, or S Corporation	Expense Sharing	PA or PC	Individual Proprietor
Assets	Shared equally or shared by partnerships, LLC, or S corporation	Some shared equally, some not shared	Owned by corporation	Owned by doctor
Expenses	Share equally or in an agreed-on proportion	Some shared equally, some shared on the basis of use, some not shared	Paid by corporation	Paid by doctor
Net income	Divided equally or according to percentage of ownership	Each doctor gets what he or she earns	Each doctor gets a salary and net income shared on the basis of each doctor's ownership	Doctor gets what he or she earns
Fees	Same for all doctors	Each doctor sets his or her Own	Same for all doctors	Set by the doctor
Billing	Combined bill	Separate bill from each doctor	Combined bill	One bill
Disability coverage	Yes	No	Yes	No
Death benefits	Yes	No	Yes	No
Retirement benefits	Yes	No	Yes	Yes
Provision for continuity of practice	Yes	No	Yes	No
Obligations to cover for each other	Mandatory	None	Mandatory	None
Records	Merged	Separate	Merged	Owned by each doctor

LLC, Limited Liability Company; PA, Professional Association; PC, Professional Corporation.

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