

Quarterly Supplement To

Business, Legal, And Tax Planning for the Dental Practice

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The purpose of the Quarterly Supplement is to continually update the material contained in **Business, Legal, And Tax Planning for the Dental Practice**, Second Edition, as "free-standing" articles relative to current business, legal, tax and pending legislative matters that affect your practice. These Quarterly Supplements also reflect my ongoing experiences as an attorney representing dental and dental specialty practices. At times, articles will be written by friends who consist of tax attorneys, accountants, actuaries and dentists. The articles contained in the Quarterly Supplements are consistent with the chapters contained in my book, which you may download at www.wickenslaw.com at no charge.



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The Balancing Act — Technology Versus Cost

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THE BALANCING ACT — TECHNOLOGY VERSUS COST

The purpose of this article is to share some of my observations on the benefit versus the cost of technology as a former dental equipment and supply representative of 16½ years and as a lawyer representing dentists for the past 19 years.

At a recent conference, a practice broker, who also happens to be a lawyer, told the group that a retiring dentist he knows, but did not work with, purchased over \$200,000 in technology and cannot recoup its cost from the practice sale. Unfortunately, this violates **rule one of this article. That is, retiring dentists should not be spending large sums on technology that may not be used by the purchasing dentist or specialist.** Let the new doctor make his or her own purchases of technology.

A young dentist decided to establish a practice. Unfortunately, equipment purchases for the new facility included substantial technology and the young doctor is facing potential bankruptcy as the result of the additional debt without sufficient patients to obtain the benefits that the technology could yield. **Rule two, do not purchase technology with insufficient patients in your practice.**

The young, but established dentist, decided to invest almost \$50,000 in a digital x-ray system. The dentist was told by the manufacturer's representative that the system could be removed if it did not perform to expectations and it did not. The representative would not return calls from the doctor to remove the system after it was purchased and paid for by lender financing. **Rule three, have your attorney review contracts for the technology to ensure that you understand what you have agreed to.** The contract did not provide that the technology could be returned and the purchase price refunded. There was an interesting observation here. The company that sold the digital x-ray system was not a dental equipment and supply company. It was a company that this dentist would use for a one-time purchase and on a limited basis thereafter. The dentist was used to working with the dental dealer who "makes things right" and would be continually servicing this dentist over the dentist's entire career. We were forced to file a lawsuit and the company immediately removed the technology and refunded the full purchase price. No, we did not charge the dentist \$50,000 to get the \$50,000 purchase price back. But that could easily happen, so have your attorney review the contract before, not after, you sign it.

Consider the dentist approaching age sixty who wanted to relocate the practice to a building that the dentist had purchased and hire an associate. The associate was to buy into the practice and purchase the first half, then later purchase the second half upon the departure of the owner. The practice owner purchased technology for a rather high cost when the costly facility was built-out. The associate could not adapt to the technology, did not want to pay for the use of the technology and left the practice. Now the owner has to work long hours to cover the overhead and earn a living. At this point, the owner is searching for a dentist to purchase the entire practice and building. The practice happens to be in a problem geographic area where jobs are being lost. Notwithstanding that the relocation should not have taken place at all, **rule four is that if you invest in technology and have or plan to have an associate in your**

practice, you limit the associate pool to those dentists or specialists who can or will learn to effectively utilize and pay for the technology. One more interesting tip here, the building is financed in a way that will require lender approval before the building can be sold to anyone, including a new dentist who will purchase the practice. Not good!

Two partners/shareholders purchase technology that would be used by one and not the other. The technology cost was allocated to the dentist who uses it and the other is unaffected. This requires a careful analysis of "direct business expenses" with a CPA who is experienced in representing dental and dental specialty practices. **Rule five is partners may allocate technology on the basis of usage.**

A multi-specialty practice desires to install expensive technology for implants. We meet with the CPA, who is designated the gatekeeper to determine whether the technology is appropriate at this time for this practice and it was. A cost versus benefit analysis was undertaken with the assistance of the specialists who sat with the CPA to determine the number of patients per month who would benefit from the technology, the cost per patient and how the fees would be paid. We also discussed the commitment of the doctors to follow-through on the use of the technology, the planned training of the staff and overall implementation of the technology in the practice, given the specific facility design. The facility is new. As part of the overall implementation in light of the cost, we analyzed patient acceptance and budgeted a marketing campaign with an outside advertising consultant. So far, so good. As to the gatekeeper to the financing, the accountant also determined items such as lease versus purchase, repayment period, interest rate percentage, interest rate calculation, prepayment penalty, accelerated depreciation and expensing deductions and credits, additional fees generated from the technology, personal guarantees and blanket security issues. But most important, based upon the information provided by the doctors to the accountant, the accountant calculated the anticipated return on investment from the technology. This item will be monitored on an on-going basis and in this case, we hold semi-annual meetings with all advisors. **Rule six, involve your advisors in the decision making process for technology purchases.**

As an example, assume that technology in a given practice costs \$200,000. It is financed over five years at 8% for an approximate yearly cost of \$48,663. If we further assume that this practice maintains a 40% profit margin of owner compensation and benefits in all forms, we would desire to maintain the same proper percentage and not have to give the non-doctor's spouse the bad news of having to take a pay cut. Here's the calculation:

$\$48,663 \text{ divided by } .6 = \$81,105.$ This represents the additional yearly revenue to maintain a 40% profit margin and pay for the cost of this technology.

To maintain the same pay and benefits, the practice would have to collect an additional \$48,663.

Rule seven, authorize your CPA to calculate your anticipated return on investment.

Note that I did not use a seven or ten year repayment period as in this example I have made the assumption that the technology will have a useful life of five years. Therefore, **rule eight, match the repayment period for the technology to its useful life.**

As an additional example, assume that the practice is planning to add an associate who will hopefully be elevated to ownership after pre-determined quality and production objectives are consistently met. Because the facility is too small, it must relocate to have sufficient space for the associate. The equipment and build-out cost is \$350,000 and will be repaid over 10 years because we believe that the useful life of the equipment and build-out will be at least that long. With an interest rate of 8%, the yearly repayment would be approximately \$50,958. To maintain a 40% profit in all forms, the required additional yearly revenue would equal \$84,930. If the \$200,000 in technology is also purchased or leased, the required additional yearly revenue to maintain a 40% margin would equal \$166,035. For the practice owner to maintain the same pay and benefits, the practice would have to collect an additional \$99,621. What your accountant cannot tell you is where this additional revenue will come from. If you believe the nice sales person at the dental meeting who says that the revenue will increase due to the technology purchase, you need to take the responsibility to ensure that it does. This requires change!

As a summary, here are the rules for technology purchases in my experience:

1. Retiring dentists/specialists should not spend large sums on technology that may not be used by the purchasing dentist or specialist.
2. Do not purchase technology with insufficient patients in your practice.
3. Have your attorney review contracts for the technology purchases to ensure that you understand what you have agreed to.
4. If you invest in technology and have or plan to have an associate in your practice, you limit the associate pool to those candidates or specialists who can or will learn to effectively utilize and pay for the technology.
5. Partners may allocate technology costs on the basis of usage.
6. Involve your advisory team in the decision making process for technology purchases.
7. Authorize your CPA to calculate your anticipated return on investment.
8. Match the repayment period for the technology to its useful life.

Over my career, I have seen many offices with technology that was not utilized well, if at all. The difference from then an now is that the technology cost is much higher. You need to be committed to using the technology and need sufficient patients to purchase it. Purchasing technology, at least in my view, would probably not bring you new patients without an advertising budget. But all in all, newer technology will continually be available in dentistry and will improve patient treatment. The challenge is that patients need to be educated that quality dentistry is expensive and will probably be an out of pocket cost.