

Quarterly Supplement To

Business, Legal, And Tax Planning for the Dental Practice

Second Edition

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 no charge at www.PrescottDentalLaw.com.



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**Ten Questions On Associate Employment —
The Associate's Perspective**

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TEN QUESTIONS ON ASSOCIATE EMPLOYMENT —
THE ASSOCIATE'S PERSPECTIVE

I. What steps should the young doctor take to find a quality position as a dentist or specialist?

Answer: The first step is to attempt to determine what you want. If you are planning to purchase a practice or establish a practice you are probably not contemplating an associateship, although you may be considering all choices simultaneously and you will have to evaluate the best opportunity for you. Assuming that you are looking for an associate position, figure out the characteristics of the ideal practice for you. Geographical area, manner of patient payment, urban versus rural, clinic versus private practice, full versus part-time are just a few of the choices to consider. Next, decide where you want to live and practice. You may be considering multiple geographic areas.

One interesting situation that has been evolving for several years is that clinics can generally afford to pay you at a higher wage than private practices. However, private practices provide a much better path to ownership than does a clinic environment. If you do plan to work for a clinic and later change to private practice, attempt to make sure that your expenses do not rise to the level of your income. Otherwise, you will have a difficult time making a switch from a clinic to private practice. Yes, some clinics are now providing for ownership, but note that you will have the clinic for a partner and your ability to sell your practice in the future will be usually limited to a clinic doctor.

When do you think about your choices? As soon as you can while in dental school and, hopefully, you will want to have all of this determined before you graduate. Granted, your situation can change and that's okay. Also, be alert to unexpected opportunities.

As a second step, assemble your advisory team. This team should consist of your attorney and accountant, experienced in representing dentists and dental specialists. Always expect to know how and when you pay all advisors. Your advisory team can guide you through your practice entry choices. In addition to your attorney and accountant, you will undoubtedly have contact with other advisors, e.g., dental lender, insurance, dental dealer or practice broker. Once you have selected your advisory team, place them on standby until you need them and expect them to be available on short notice. Err on using advisors sooner than later so that earlier decisions do not need to be undone. The internet, your dental dealer, dental societies and associations and other advisors that you come into contact with can be sources of advisor referrals. Remember experience is important. Otherwise, your team cannot help you assess multiple practice entry options or determine the right practice for you. We like to see the practice owner's advisory team prepare the appraisal and agreements. This way, your advisory team can review what has been prepared, assuming the appraisal and all agreements have been properly completed. This is why experience is so important for advisors for both you and the practice owner. For co-ownership, the most complex form of practice, consider asking for a signing bonus to pay your advisory team.

Prepare a letter of introduction, along with a resume and referral sources to provide to potential employers. Always obtain permission from the referrals sources to provide their names as referrals.

Next, contact the dental equipment and supply dealers in the geographic area(s) that you have selected to locate opportunities that may be available. The dental dealer knows the practice owners who are looking for an associate and the opportunities that may be available. Contact practice brokers in the desired geographic area(s), as they may also be aware of excellent opportunities. Most practice brokers work with general dentists, although some work with specific specialties. You should not pay the broker, the practice owner should. If a broker asks you to sign a contract, it should not be exclusive and have your lawyer review it prior to signing. Look at professional journals and associations for opportunities. Also consider placing an advertisement in selected journals at the state, local and national levels. Contact dental schools within the geographical area(s) that you are considering for possible positions. Often, practice owners contact the local or their dental school to assist them in a candidate search, typically at no cost to anyone. Visit the geographical area(s) that you have selected and drive past or visit locations that you think would fit your objectives. If you locate a desirable practice, send the owner(s) your letter of introduction package. Unfortunately, you need to earn a living, and the available opportunities may not fit your objectives. In this case, accept the opportunity that fits best.

II. What are the key questions that should be asked during the first, then subsequent, employment interviews?

Answer: The employment interview questions should be the same for you and the practice owner. Questions should relate to the categories of mutual expectations on quality and quantity of production, vision about the practice of general dentistry or your specialty, mentorship, how the production will be accomplished (e.g., use of specific treatment rooms, patient assignment and work schedule) and future ownership after the associate period. My recommendation on the second or third interview is for the associate to sign a confidentiality letter and request the practice valuation, which the practice owner should have authorized to be completed before conducting any interviews. Your advisory team would also request financial and tax information about the practice in question. This assumes that the relationship is not one of a permanent associateship or clinic position. Beyond the appraisal, you need to specifically know how you will be elevated to ownership or purchase of the practice. In other words, the practice owner's succession or exist strategy should be definitive. Otherwise, you cannot make informed decisions about your future. In addition, the specific business and tax structure of any co-ownership or solo group should be delineated with agreements in place before you pick-up a handpiece.

III. How can the young doctor determine if the practice can support an associate?

Answer: First, determine your monthly collections for the first three years of employment. Your collections will be through pent up practice demand and patients you will bring to the practice through your own internal and external marketing efforts. Yes, you really need to build a practice within an existing practice. Most practices that consider adding an associate have more production than the existing owner can handle, but not enough for you to be fully booked. Plan on presenting full and comprehensive new patient exams and focus on internal patient referrals, community involvement and external marketing efforts to build your practice within a practice.

Second, determine your anticipated compensation, benefits, payroll taxes, direct business expenses, dental assistant, loan repayment for dental equipment purchased for you, lab and any other variable costs relative to your employment.

Third, determine the breakeven point of your yearly cost to the practice in light of your yearly collections, inclusive of hygiene exams. For example, if you earn \$120,000 per year and have \$50,000 of additional costs attributable to your employment, your yearly breakeven point is

\$170,000, without any contribution to fixed costs. You contribute to fixed costs above \$170,000 of yearly collections, except for laboratory and supply costs. The business rule is that if variable costs are covered and there is some contribution to fixed costs, then hire the associate. There will also be times when it is advisable for the practice owner to hire the associate even where variable costs are not completely covered for some period of time.

My advice to practice owners is to get their management systems in place, fees reviewed, then hire the associate if demand or potential demand warrants the hiring. In a general practice, the rule of thumb is 2,000 active patients before hiring an associate. Active patients are patients seen in the last 18 months.

The facility is important in your situation. A small facility with limited space will not allow you to be sufficiently productive. Assess whether the practice owner recently relocated or expanded or what the strategic plan is for doing so. Practices that have just relocated or expanded have already made the conscious or unconscious choice to hire a new dentist or specialist.

Finally, be cautious of the practice that can hire you only for one to two days per week. You will need to also practice elsewhere. This is almost like establishing a practice from scratch, but without the cost of the facility or equipment. You need to know up front what you will be asked to pay later to be admitted to ownership. Also, be aware of limitations of any restrictive covenants because you will be working at another practice which will also require you to sign a restrictive covenant. In essence, a double restrictive covenant.

IV. Is the young doctor an employee or independent contractor and why?

Answer: You are an employee and not an independent contractor, except in rare circumstances. The same holds true for the retiring dentist or specialist rendering services in your newly purchased practice. Where the practice schedules the patients, pays you, employs the staff, pays the operating expenses, you are subject to a restrictive covenant and have an expectation and/or option to purchase an interest in or the practice in the future, your relationship provides sufficient behavioral and financial control to be classified as an employee. While working part-time, forming your own entity and working at other practices is helpful in a finding of independent contractor status, these factors are not determinative.

On the other hand, if you rent space, bill the patients you treat, control your work schedule, do your own scheduling and pay the practice for use of the space, you could be properly classified as an independent contractor. It would also be helpful if you treat your own patients and you are free to retain those charts should the relationship terminate, other than your promise not to solicit or treat patients of the host's practice.

Employers prefer independent contractors because payroll taxes and fringe benefits are avoided. It costs the practice less to treat you as an independent contractor versus treating you as an employee. You would want to be classified as an independent contractor so that benefits, insurances and direct business expenses can be offset against your income.

Consultants often ask, "if the employer and independent contractor pay all applicable taxes, no harm no fowl, right?" The IRS has said "no". Where misclassification is found, the practice is assessed all federal income taxes, fines and interest with limited ability to get the funds back from you. You would effectively be denied the benefits, insurances and direct business expenses. In short, this is a disaster and the IRS is significantly increasing its audit efforts on worker classification and sharing information with 39 states and vice-versa.

What does work, however, is that the practice can pay you well, then reduce your compensation by the full cost of your benefits, insurances and direct business expenses not paid by the practice.

V. Should an employment agreement be prepared or is a letter stating the employment terms sufficient to start work and who prepares the document?

Answer: Some advisors believe that an employment agreement is unnecessary for the first six months of employment, that just a letter of employment terms is sufficient. I respectfully disagree, although it would be advantageous for you not to have a restrictive covenant for the first six months of employment. Almost every time we attempt to have an employment agreement signed after the employment has commenced, we have disagreements over the terms of the restrictive covenant provisions. I just do not see sufficient detail in an employment terms letter to eliminate negotiations on this and other issues. For example, there may be a two-year, five-mile restrictive covenant, with non-solicitation provisions contained in the letter. However, your counsel may attempt to negotiate that the covenant should be null and void, if the practice terminates your employment without cause. Your counsel may also attempt to negotiate a buy-out of the covenant to allow you practice within the restricted area. These and other points should have been agreed to from the beginning. Let the practice owner's lawyer prepare the employment agreement. This way, your attorney reviews only. Assuming that the employment agreement is properly prepared, this is less expensive than the cost of preparation. Let the practice owner's lawyer prepare the employment agreement. This way, your attorney reviews only. Assuming that the employment agreement is properly prepared, it is less expensive than the cost of preparation.

VI. Why are the restrictive covenant provisions so important to the associate employment agreement and what do they include?

Answer: Restrictive covenant provisions are crucial in the event that the working relationship fails. The associate should never want to be forced to relocate should the relationship terminate for any reason. The key terms of any restrictive covenant are confidential information (patient and/or referral sources), time, geography, non-solicitation of patients and referral sources (if applicable) and non-solicitation of employees. In associate employment, the duration of the restrictive covenant is one to three years, typically two years. On the other hand, if the associate buys-out the owner or buys the practice, the restrictive covenant to the former owner is typically three to five years. The geographic radius may include a map which may be a freeway on one side and a community on another or two miles in one direction, eight miles in another and so forth. Be very careful of overly broad restrictive covenants. For example, if you are asked to sign a 50 mile restrictive covenant and the relationship fails, you need to go 50 miles away to practice. This means you would have to relocate to find employment. Are restrictive covenants enforceable? Generally, they are, although each state has different criteria. If you sign a restrictive covenant and the employment terminates, the practice owner usually has more resources than you to both obtain an injunction to stop you from practicing in the area and seek monetary damages. Be careful of liquidated damage provisions. They are not usually reflective of the damage caused to the practice by any violation of the covenant. For those situations where you find employment in the community where you grew up, you should request the ability to buy-out the covenant. The price should equal the goodwill value of patients that you customarily treat. This would apply only if you practice inside of the restricted area and you would not be permitted to either solicit or accept the practice owner's patients. In the first year, there may be a minimum cost to the buy-out of the covenant and in subsequent years, it would be based upon the calculation of the goodwill of those patients you customarily treat, e.g., 40% of your collections over the last 12 months of employment.

VII. How should the associate be paid compensation and benefits and how do specialists differ from general dentists?

Answer: Your compensation should be determined in advance of the hiring process through an analysis by the practice owner's advisors of what the practice can afford to pay with the owner earning a 5% to 15% administrative profit. This should also consider the geographic area and the difficulty of locating candidates within such area. On your end, you need to determine your compensation requirements based upon living expenses, debt and relocation costs.

As an example, assume that the practice agrees to pay you the greater of \$7,000.00 per month or 30% of adjusted production. You receive credit for hygiene examinations, but not hygiene services or x-rays performed by the hygienist(s). Assume further that the practice pays your liability insurance, one-half of individual health insurance premiums, \$1,000 per year toward the cost of continuing education and professional dues. This seems like a fair compensation package, right? But how do you become an owner?

There needs to be a sufficient difference between your compensation, benefits and direct business expenses and owner compensation to allow for your future ownership. This difference, inclusive of hygiene collections attributable to you, must allow for your ownership without a reduction in your pay, over a specified period of time, e.g., seven years. This can be quantified based upon anticipated yearly collections, practice overhead percentage and the practice appraisal. If this does not work, the appraisal is flawed.

What is an appropriate rate of compensation? The greater of a monthly base salary for full-time employment or a daily or hourly rate for part-time employment or percentage of adjusted production or collections equal to 28% to 32% for a general dentist (with the practice paying the laboratory costs) or 35% to 45% for a specialist. Another way to pay you is 25% of adjusted production, inclusive of all hygiene services. The base salary should not be a draw to be repaid in the future. Adjusted production means your production, less write-offs, refunds, uncollectible accounts and/or laboratory remakes. Once predetermined production levels are consistently reached, the monthly compensation based upon a percentage will exceed the base salary. The base salary may only be in effect for a limited period of time, e.g., 90 to 180 days. I like adjusted production rather than collections because you do not control the collection policy of the practice.

If the practice owner and you do agree to a draw to be repaid from your future compensation percentage, negotiate a provision where you are not required to repay any draw above the compensation should you leave the practice. If you are paid on collections, the employment agreement should contain the provision whereby your collections would continue to be paid for some period of time after your employment ends. There also should be provision that you receive a for monthly accounting of those collections.

In a general practice, the methodology for any payment of laboratory expenses should be delineated. For example, 35% of collections, less 35% of laboratory costs, is different from collections, less 35% of laboratory costs, multiplied by 35%. It may be helpful to include any laboratory expense calculation as an example in a schedule to the employment agreement.

Bonuses are designed to economically reward work over and above the standards expected by your employer. In dental practices, bonuses usually take the form of a reward for exceeding a predetermined level of productivity or collections. Designing a bonus formula only based upon productivity or collections is one dimensional. Associate bonuses should be designed to measure and reward quality of work, effort, attitude, overall performance, yet consider the cash and

financial position of the practice. In short, bonuses should be discretionary for associates. You should benefit from a discretionary bonus in that important criteria in addition to productivity, e.g., quality of services, are evaluated. Because the associate period is a time of mutual evaluation for both parties, you can and should assess the fairness of the practice owner and vice-versa. There should also be an evaluation form in place, and the practice owner should evaluate your performance in writing and discuss it with you on a quarterly basis. The employment agreement may provide that you must be employed on the last day of any calendar or fiscal year to be eligible for any bonus. Other bonuses may include a one-time signing, relocation or bonus to pay your advisors.

Specialists are usually paid a base amount, e.g., \$150,000 - \$200,000 per year, payable over 12 months during the usual and customary pay periods of the practice. Bonuses are less common in specialty than in general practices.

VIII. What are the other important provisions that should be contained in an associate employment agreement?

Answer: In addition to compensation and restrictive covenants, there are other important provisions. First, vacations and other time-off consist of vacation time, continuing education days, personal days and illness. Second, termination of employment is important. Both the practice owner and associate need to be able to disengage from each other. Certain "for cause" termination events, by either party, may include a short cure period. I suggest that termination by notice be the same number of days for you and the practice, 30 - 90 days. Finally, duties, responsibilities, licensure and mutual hold harmless provisions should also be included in the associate employment agreement.

IX. How and when is practice ownership contemplated?

Answer: Dealing with practice ownership a year or two after the associateship begins will not work, irrespective of a complete sale or co-ownership. You and the practice owner will not agree on the valuation date, purchase price for the buy-in, the operations, the formula or purchase price for the buy-out or the business and tax structure of the co-ownership. This needs to be addressed prior to commencement of your employment.

Co-ownership is the most complex form of practice as compared to sole ownership. This is because you and the practice owner need to deal with three categories; the buy-in, operations and the buy-out. The buy-in is typically internally financed, unless the practice owner grants a security interest to the lender. I do not recommend this. The buy-out should be paid in cash with you as the sole remaining owner under any triggering event. The triggering events include retirement (as a defined term), death, permanent disability, dispute or other termination of employment. If you leave voluntarily, you get no windfall. If the practice owner terminates your employment, the practice owner pays you a windfall. Your buy-out, should you leave, is reduced by the unpaid sum of the internally financed buy-in. Operations cover your working relationship as owners, including allocation of owner compensation, decision making control and employment of family members. Usually, the founding owner retains certain founder's rights until you have paid for your ownership interest, although certain decisions, e.g., the hiring of another doctor, should require unanimous consent.

Adding to the complexity of the buy-in, operations and buy-out, there are three business and tax structure for co-ownership. See my article, **Co-Ownership, a taxing relationship**, Dental Economics, September, 2010.

Solo group arrangements provide a good alternative to co-ownership because while you may be willing the purchase the first half of the practice, you may not desire to be obligated to purchase the second half. In the solo group, you buy half of the tangible assets of the practice and an undivided half interest in the goodwill of the owner. The goodwill is attributable to the owner's patients that you customarily treat, not patients that you personally bring to the practice. Because you will own your own practice, you can obtain a loan for the purchase price from a dental lender. After the purchase, you and the practice owner operate your practices in the same facility under an office sharing agreement. While you and the owner will have a buy-sell agreement in place, you would have an option, but not an obligation, to purchase the second half of the owner's practice upon the owner's retirement. An exception to this would be the death or permanent disability of either of you, which should require a mandatory purchase. Should there be a falling out, you take your patients and leave, along with your equipment. You would also be paid the fair market value of any jointly owned equipment with the other solo group member.

As to the value of a practice, the average is now roughly 65% of one year's collections, excluding accounts receivable and debt in a complete sale. Some specialties, such as orthodontics, are higher and some lower. The average value of a fractional sale is identical, although I believe that accounts receivable and debt should be included. While I have written about 30 factors that affect practice value, the two biggest factors are practice collections per year and the percentage of owner profit in all forms to one year's collections. Most practices do not sell for an average value. Average value is merely a compilation of higher and lower values. In any valuation formula, there are four important verification points. They are; you need to earn a reasonable living, pay the purchase price, pay your operating expenses and do so within a measured period of time (not to exceed five to seven years). While dental lenders will grant loans for 10 years and longer, the practice value should be based upon full repayment of the purchase price, be it a complete or fractional sale, over five to seven years. Otherwise, the price is increased due to an increased repayment period.

As a result of this complexity, I recommend to practice owners that before the associate begins employment, the associate employment agreement, appraisal and all ownership agreements should be prepared. At a minimum, we need a very detailed letter of understanding delineating the anticipated practice purchase, co-ownership or solo group arrangement.

X. What are your final thoughts on associate employment?

Answer: For you, it's not easy finding the right position. For practice owners, it's not easy locating the right associate. Associates and practice owners should use all available resources to find each other and this is not easy. However, live your dreams and, over the long term, do not settle for less than the ideal practice for you.